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IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

NATIONAL CABLE TELEVISION ASSOCIATION, INC.,
Petitioner,

v.

BELL ATLANTIC CORPORATION, *et al.*,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the court of appeals incorrectly held that 47 U.S.C. § 533(b)—enacted in 1984 as a presumptive bar on the local telephone monopolies' entering the cable television business in their telephone-service areas, but allowing entry where there is good cause—is invalid under the First Amendment.

PARTIES TO THE PROCEEDING

Petitioner, the National Cable Television Association, Inc., was an appellant in the court of appeals, along with respondents United States of America, Federal Communications Commission, and Janet Reno, as Attorney General of the United States. The remaining respondents, who were appellees in the court of appeals, are the Bell Atlantic Corporation and its relevant subsidiaries: The Chesapeake and Potomac Telephone Company of Virginia; The Chesapeake and Potomac Telephone Company; C&P Telephone Company of Maryland; The Chesapeake and Potomac Telephone Company of West Virginia; the Diamond State Telephone Company; The Bell Telephone Company of Pennsylvania; New Jersey Bell Telephone Company; and Bell Atlantic Video Services Company.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner National Cable Television Association (NCTA) petitions for review of the decision of the United States Court of Appeals for the Fourth Circuit holding that 47 U.S.C. § 533(b)—the telephone-cable cross-ownership statute—is invalid under the First Amendment.[1]

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-45a) is reported at 42 F.3d 181. The opinion of the district court (Pet. App. 46a-93a) is reported at 830 F. Supp. 909.

JURISDICTION

The judgment of the court of appeals was entered on November 21, 1994. Pet. App. 3a. Timely petitions for

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[1] Pursuant to Rule 29.1 of the Rules of this Court, petitioner NCTA states that it has no parent company and no subsidiaries.

rehearing were denied on January 18, 1995. Pet. App. 94a-96a. Chief Justice Rehnquist subsequently extended the time for filing a petition for certiorari to May 18, 1995. Pet. App. 97a.

STATUTORY PROVISION INVOLVED

Section 533(b) of Title 47, United States Code, provides:

> (1) It shall be unlawful for any common carrier, subject in whole or in part to subchapter II of this chapter, to provide video programming directly to subscribers in its telephone service area, either directly or indirectly through an affiliate owned by, operated by, controlled by, or under common control with the common carrier.
>
> (2) It shall be unlawful for any common carrier, subject in whole or in part to subchapter II of this chapter, to provide channels of communications or pole, line, conduit space, or other rental arrangements, to any entity which is directly or indirectly owned by, operated by, controlled by, or under common control with such common carrier, if such facilities or arrangements are to be used for, or in connection with, the provision of video programming directly to subscribers in the telephone service area of the common carrier.
>
> (3) This subsection shall not apply to any common carrier to the extent such carrier provides telephone exchange service in any rural area (as defined by the Commission).
>
> (4) In those areas where the provision of video programming directly to subscribers through a cable system demonstrably could not exist except through a cable system owned by, operated by, controlled by, or affiliated with the common carrier involved, or upon other showing of good cause, the Commission may, on petition for waiver, waive the applicability of paragraphs (1) and (2) of this subsection. Any such waiver shall be made in accordance with section

63.56 of title 47, Code of Federal Regulations (as in effect September 20, 1984) and shall be granted by the Commission upon a finding that the issuance of such waiver is justified by the particular circumstances demonstrated by the petitioner, taking into account the policy of this subsection.

STATEMENT

I. Administrative And Statutory Background.

The telephone-cable cross-ownership rule, 47 U.S.C. § 533(b), grows out of familiar concerns about monopoly power, as applied to local electronic communications media. When a monopolist in a regulated market (here, local telephone service) enters an adjacent business subject to less regulation (here, cable service), it has inherent opportunities and economic incentives to use the newly entered business to try to escape the regulatory constraints inhibiting full exploitation of the initial monopoly. Through cost-shifting, discriminatory self-preference, and related techniques, the monopolist may simultaneously extract greater monopoly profits from the monopoly ratepayers and engage in harmful, unfair competition in the entered market. The problem is particularly severe if the two businesses (telephone and cable), though currently separate, are potential rivals, so that unfair competition in the entered market may reinforce and protect the monopoly. Section 533(b) chooses simple structural separation, rather than complex administrative standard-setting and oversight, to address these problems, aiming to foster and preserve the presence of two wire networks, rather than one wire network, for local electronic communications.

A. In the late 1960s, the Federal Communications Commission examined telephone company efforts to prevent the development of an independent cable television industry, then in its infancy. In 1968, the Commission required telephone companies to obtain certification,

under 47 U.S.C. § 214, before constructing, acquiring, or operating video transmission facilities. *General Tel. Co. of California*, 13 F.C.C.2d 448 (1968), *aff'd*, *General Tel. Co. of California v. FCC*, 413 F.2d 390 (D.C. Cir.), *cert. denied*, 396 U.S. 888 (1969). The FCC noted that "[b]y reason of its control over utility poles, or other local advantages resulting from its status as an existing common carrier in the community, the telephone company is in a position to preclude or to substantially delay an unaffiliated CATV system from commencing service and thereby eliminate competition." *Id.* at 463. The Section 214 process subsequently revealed that telephone companies had in fact discriminated in favor of their affiliates and "otherwise improperly extended their existing monopoly in the telephone field to CATV services." *Applications of Telephone Companies for Section 214 Certificates*, 34 Fed. Reg. 6290, 6290-91 (1969).

In 1969, therefore, the Commission proposed to address the problems of "undue concentration of control of CATV systems by telephone companies," "anticompetitive practices" by telephone companies, and "possible unfair competitive advantages" of telephone companies in the cable business, such as the ability of telephone companies to "subsidize the cost of construction and services required by their affiliates out of revenues derived by the telephone companies from their other services." *Id.* at 6292. In 1970, the Commission concluded that the proper response was a rule that presumptively barred telephone companies from providing cable television service within their local exchange areas, except upon grant of a Commission waiver. *Applications of Telephone Companies for Section 214 Certificates*, 21 F.C.C.2d 307, *recons. in part*, 22 F.C.C.2d 746 (1970), *aff'd*, *General Tel. Co. of the S.W. v. United States*, 449 F.2d 846 (5th Cir. 1971). The Commission rule, which from the beginning has provided for waivers of the prohibition upon a showing of "good cause" (and in other specified circumstances), is codified in its current form at 47 C.F.R. §§ 63.54-.56.

In adopting its rule, the Commission explained that "the prevention of undesirable concentration of control of communications media has always been of great concern" (21 F.C.C.2d at 328) and noted the Justice Department's conclusion that telephone companies were "seeking to extend their regulated telephone monopoly into the areas of CATV [cable television] and broadband coaxial cables, primarily to assure themselves of control over the services broadband coaxial cable will perform in the future" (*id.* at 324). The Commission pointed specifically to telephone companies' ability, by virtue of their "monopoly position," to discriminate against cable operators seeking essential access to telephone poles and underground conduits for their cable television wires. *Ibid.* The Commission also noted evidence that telephone companies with cable affiliates "can subsidize those affiliates with revenues obtained through telephone company operations." *Id.* at 311.

In 1981, the Office of Plans and Policy of the Commission produced an extensive report, *FCC Policy on Cable Ownership: A Staff Report*, reviewing and reaffirming the need for the in-region cross-ownership rule. Ct. App. JA 6574.[2] The report pointed to the practice of cost-shifting, which "allow[s] a telephone company partially to avoid rate-of-return regulation on its telephone service . . . by attributing costs to the regulated telephone division and revenues to an unregulated cable division." *Id.* at 153. The report explained (*id.* at 158) that the resulting higher telephone rates and monopoly profits, as the district court summarized the point, "could be used to underprice competing cable television operators, forcing them out of business, thereby enabling the telephone companies to leverage their regulated local exchange monopoly into an additional monopoly of video transmission

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[2] Three years earlier, Congress had enacted the Pole Attachments Act of 1978 to "regulate the rates, terms, and conditions for pole attachments," 47 U.S.C. § 224(b)(1), but not to guarantee access in the first place. *See FCC v. Florida Power Corp.*, 480 U.S. 245, 251 n.6 (1987).

services." Pet. App. 52a. The FCC report noted the inadequacy of regulatory solutions: "One of the most difficult aspects of telephone regulation is the assignment of costs to their causes. Cable and telephone systems share a certain amount of capital equipment; allocating shared costs between these capital accounts on the basis of actual cost causation will be difficult or impossible." *1991 Report* at 157.

The Commission's rule thus addressed familiar problems—discriminatory self-preference and cost-shifting by the local exchange companies, the very conduct that led to the 1982 Bell System breakup under the Sherman Act—rooted in the basic economic incentives present when a monopolist in one market, where rates are subject to regulation tethered to costs, enters a less tightly regulated business that is vertically integrated or involves shared costs.[3] The telephone monopolist can earn some of its otherwise-restrained telephone monopoly profits by adding costs to the telephone business (thus propping up telephone rates), both by incurring otherwise-unwarranted substantial new costs (*e.g.*, a new fiber-optic network) and by allocating to the captive telephone business an improper portion of the costs shared with the non-telephone business. If rivals in the non-telephone business need to depend on the monopoly business (*e.g.*, if video-programming retailers use telephone transmission lines), the monopolist also can exploit its regulated monopoly through discrimination against its rivals. The effects are

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[3] The incentives depend only on the non-telephone business being subject to less restrictive rate regulation or greater elasticity of demand. *See* Ct. App. JA 276 (Owen Aff. ¶ 20) ("The incentive to engage in anticompetitive conduct in a second market is not eliminated by regulation of that market. Differences, either in regulatory treatment, *e.g.*, allowed rate or return, or in the elasticities of demand in the two markets, are generally sufficient to make it profitable for a regulated telephone company to expand in order to evade regulation of its telephone profits.")

two-fold: harm to telephone ratepayers[4]; and unfair competition in the entered market.[5] These incentives and techniques for escaping regulatory constraints on a monopoly market through a second market, and the consequent harms, are well recognized not only by the Commission but also by the courts,[6] by the Justice De-

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[4] *See* Ct. App. JA 271 (Owen Aff. ¶ 11) ("customers in the primary market are injured by being required to pay more for the monopolist's goods").

[5] Bell Atlantic's expert explained: "this could indeed confer an unfair advantage on the telephone company in its competitive markets, and could conceivably enable it to drive its competitors out of business." Ct. App. JA 179 (Kahn Reply Aff. ¶ 6); *see* Ct. App. JA 271 (Owen Aff. ¶ 11) ("the monopolist injures competition in the second market by displacing more efficient competitors, and perhaps even by monopolizing the second market").

[6] *See, e.g., Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973); *National Rural Telecom Ass'n v. FCC*, 988 F.2d 174, 178 (D.C. Cir. 1993) ("Firms can gain by shifting costs away from unregulated activities (where consumers would react to higher prices by reducing their purchases) into the regulated ones (where the price increase will cause little or no drop in sales because under regulation the prices are in a range where demand is relatively unresponsive)."); *California v. FCC*, 905 F.2d 1217, 1224 & n.5, 1235 (9th Cir. 1990) (discrimination problem, citing FCC sources; cost-shifting enables telephone company "to exact monopoly rents from basic service customers by burdening them with costs from unregulated activities"); *Southwestern Bell Corp. v. FCC*, 896 F.2d 1378, 1379 (D.C. Cir. 1990) ("Diversified telephone companies possess a natural incentive to shift costs to their regulated telephone service, and thereby guarantee the recovery of those costs from ratepayers.").

A similar point about the special dangers of dual-market conduct involving a regulated market has been recognized in the context of tie-ins. *See Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 36 n.4 (1984) (O'Connor, J., concurring in the judgment); *Fortner Enterprises, Inc. v. United States Steel Corp.*, 394 U.S. 495, 513 (1969) (White, J., dissenting).

partment,[7] and by the scholarly literature.[8]

B. Against this background, Congress enacted Section 533(b)—the telephone-cable cross-ownership statute—as part of the comprehensive 1984 Cable Act.[9] With only

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[7] The Justice Department's merger guidelines, which generally take a narrow view of when vertical integration is of antitrust concern, singles out for special concern the case of vertical integration involving a regulated market. *See United States Dep't of Justice Merger Guidelines* § 4.23 (June 14, 1984). In 1982, the Department explained in the Bell divestiture proceedings: "If the [local telephone companies], as rate base/rate of return regulated monopolists, were permitted to enter related competitive markets, they would have the means and incentive to disadvantage their competitors by cross-subsidization and discrimination in the terms and conditions of access to the local exchange. Neither of these problems has thus far proven amenable to successful regulatory solution." 47 Fed. Reg. 23,320, 23,336 (May 27, 1982).

[8] *See, e.g.*, Brennan, *Why Regulated Firms Should Be Kept Out of Unregulated Markets: Understanding the Divestiture in* U.S. v. AT&T, 32 Antitrust Bull. 741 (1987); M. Kellogg, P. Huber, & J. Thorne, *Federal Telecommunications Law* § 9.3.4, at 437 (1992) ("A regulated utility that is also involved in an unregulated competitive business may have both the incentive and opportunity to shift the costs of competitive operations onto the regulated side of the line."); *id.* § 3.2.4, at 144 ("Even if only partially successful, cross-subsidy may undermine competition or efficiency on both sides of the regulatory line. Prices of the regulated service may rise above cost while production of the unregulated good or service may shift into the hands of an inefficient provider.").

[9] Although Bell Atlantic has throughout this proceeding insisted that Section 533(b) is not really a "cross-ownership" rule, the Fourth Circuit recognized that this was a "merely semantic" point, since the analysis does not turn on labels. Pet. App. 9a n.8. We follow the familiar label, reflecting the facts that the provision applies by its terms to telephone company ownership of a cable business, Congress included it among the "ownership restrictions" set forth in Section 533, and "cross-ownership" is the term used by the legislative history (H.R. Rep. 934, 98th Cong., 2d Sess. 55 (1984)) and by the Commission.

We also use the term "cable" as a shorthand for the (narrower) statutory term, "video programming." *See* 47 U.S.C. § 522; *American Scholastic TV Programming Found. v. FCC*, 46 F.3d 1173 (D.C.

a few changes of language, the statute codified the Commission's rules presumptively barring the local telephone companies from entering the cable business inside their telephone-service regions (paragraphs (1) and (2)).[10] Congress also included a provision for Commission waiver upon a showing of "good cause" and directed the Commission to grant such a waiver where "justified by the particular circumstances demonstrated by [an applicant], taking into account the policy of this subsection" (paragraph (4)).[11]

The legislative history explaining the provision is sparse. The House Report recited the congressional aim "to prevent the development of local media monopolies, and to encourage diversity of ownership of communications outlets." H.R. Rep. 934, 98th Cong., 2d Sess. 55 (1984). Notably, the legislative record indicates that the provision was enacted without opposition from—indeed, with the support of—Bell Atlantic and other telephone companies. 130 Cong. Rec. 27982 (1984) (remarks of Rep. Dingell).

Cir. 1995) (§ 533(b) applies only to video programming on a "cable system").

[10] Consistent with the underlying purposes, the Commission has made clear that the statute applies, not to all "telephone" companies, but only to "traditional landline local exchange telephone companies" providing "ubiquitous, interconnected switched service" over "bottleneck facilities." *In re Application of Teleport Communications—New York*, 7 F.C.C.R. 5986, 5988 (1992).

[11] The telephone-cable cross-ownership bar was accompanied by a broadcasting-cable cross-ownership bar (Section 533(a)(1)) and by a grant of authority to the FCC to adopt additional restrictions on ownership of cable systems by owners of other media of mass communications (Section 533(c), (d)). In 1992, Congress added a bar on common ownership of a cable business and in-region "multichannel multipoint distribution service" (MMDS, a form of "wireless cable") or separate "satellite master antenna television service" (SMATV). Section 533(a)(2).

C. In 1988, the FCC tentatively concluded that it should recommend repeal of the statute. *Further Notice of Inquiry, In re Telephone Company-Cable Television Cross-Ownership Rules*, 3 F.C.C.R. 5849. While noting that commenters "have failed to present any evidence, and do not seriously contend, that carriers do not have the ability to subsidize affiliated cable operations" (*id.* at 5854), and that "telephone companies continue to have the ability to deny potential competitors access or to engage in anticompetitive cross subsidies" (*id.* at 5860), the Commission "tentatively conclude[d] that the costs of the cross-ownership ban exceed the benefits" (*id.* at 5858). The Commission specifically concluded that Section 533(b) is valid under the First Amendment (*id.* at 5864), so that its legislative recommendation of repeal was a matter of policy judgment—a judgment opposed by, among others, the National Telecommunications Information Administration (NTIA). *Id.* at 5856; *see* Ct. App. JA 8090.

In 1992, the Commission (by a 3-2 vote) formally recommended that Congress "amend the Cable Act to permit the local telephone companies to provide video programming directly to subscribers in their telephone service areas, subject to appropriate safeguards." *Second Report and Order* (*Video Dialtone Order*), 7 F.C.C.R. 5781, 5847. The Commission recognized the dangers but concluded that, if safeguards were adopted, the risks would be "outweighed by the potential public interest benefits." *Id.* at 5848-49. Both NTIA and the Justice Department now voiced similar policy views. *See* Pet. App. 55a n.8.

Congress, meanwhile, was actively considering the issue. Proposals to repeal Section 533(b) and to substitute a variety of regulatory safeguards (such as limitations on the amount of its channel capacity that a telephone company could itself use, coupled with separate corporate operations and close FCC supervision) were introduced in Congress repeatedly between 1988 and 1992. During extensive hearings, evidence was submitted

explaining the continued existence of anticompetitive dangers and the inadequacy of regulatory checks. *See* Pet. App. 55a-56a. Congress ultimately rejected all of the proposals for repeal and, in the 1992 Cable Act, opted instead for other means of regulating the cable industry, including rate regulation, prohibition of exclusive franchising, and promotion of diverse ownership of new wireless cable technologies. *See* 47 U.S.C. §§ 533(a)(2), 541(a), 543. The Senate Report accompanying the 1992 Act reaffirmed that Section 533(b) and the other cross-ownership rules still "enhance competition." S. Rep. 92, 102d Cong., 1st Sess. 46-47 (1991).

II. This Litigation.

A. In 1992, respondents Chesapeake and Potomac Telephone Company of Virginia and Bell Atlantic Video Services brought this suit in the United States District Court for the Eastern District of Virginia seeking to enjoin enforcement of Section 533(b) as invalid under the First Amendment. The original defendants were the United States, the Attorney General, and the Commission. Petitioner NCTA intervened as a defendant. Ultimately (after judgment), Bell Atlantic Corporation and its other subsidiaries offering local telephone service (all respondents here) were joined as plaintiffs—collectively, "Bell Atlantic." *See* Ct. App. JA 92.

The parties filed cross-motions for summary judgment and compiled a record that included expert economist affidavits explaining the rationale behind Section 533(b). The district court granted judgment for Bell Atlantic, holding that the statute violates the First Amendment. Pet. App. 46a-93a. The court did not discuss, and the parties did not press any argument based on, the "good cause" waiver provision of Section 533(b)(4). *See* Pet. App. 47a (treating case as involving only the presumptive bar set forth in Section 533(b)(1) and (2)).

The district court initially reasoned that the appropriate standard of review was neither strict scrutiny nor

rationality review but "intermediate scrutiny" as set forth in *United States v. O'Brien*, 391 U.S. 367 (1968), and *Ward v. Rock Against Racism*, 491 U.S. 781, 791 (1989). That standard requires that a statute be "narrowly tailored to serve a significant governmental interest" unrelated to content and "leave[] open ample alternative channels for communication." Pet. App. 60a-80a. On the second issue, the court had "little doubt that the statute leaves open ample alternative channels for communication." Pet. App. 81a. "Clearly, . . . § 533(b) operates only as a restriction on the 'manner' in which plaintiffs may speak, not as an outright ban on their ability to do so." Pet. App. 71a n.19.[12]

On the narrow tailoring issue, the district court readily concluded that "the preservation of diversity of ownership of communications outlets is a significant governmental interest" (Pet. App. 83a-84a), explained that "courts must not substitute their judgment on policy matters for that of Congress" (*id.* at 86a), and accepted that "cross-subsidization is uncontrollable by means of regulatory oversight" (*id.* at 91a & n.34). Nevertheless, the court held that the cross-ownership rule failed intermediate scrutiny for the sole reason that, in the court's view, there was no greater possibility of exploitation of monopoly power from telephone companies' entry into cable than from what is currently permitted—offering of

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[12] The court detailed some (though not all) of the ways Bell Atlantic may offer video speech. "Plaintiffs may provide video programming to audiences outside their service area, and may speak through any type of non-video medium to audiences inside their service area. Even more significantly, however, plaintiffs may also reach audiences within their service area with video programming. Section 533(b) only prohibits plaintiffs from *directly* providing video programming to their subscribers. Plaintiffs are not prohibited from producing their own video programming and marketing it to broadcasters or cable operators for transmission by means other than the plaintiffs' own facilities. Public access requirements ensure that such programming cannot be silenced by the entities responsible for the direct provision of video programming." Pet. App. 71a n.19.

common-carrier video *transmission* service to unaffiliated programmers, who then independently sell programming to consumers. *Id.* at 91a-92a ("[t]he essential point is that telephone companies may already, under existing law, compete in the video transport market, and if it were possible for them to reap supracompetitive profits in that market through cross-subsidization, the telephone companies could do so irrespective of § 533(b)"); *id.* at 88a. The district court enjoined enforcement of Section 533(b) against Bell Atlantic and its various subsidiaries. *See* Pet. App. 5a.

B. The Fourth Circuit affirmed. Pet. App. 1a-45a. The court began by stating that it need not consider the waiver provision of Section 533(b)(4), which the court described—overlooking the "good cause" standard—as limited to situations where cable service could not be provided except by a telephone company. Pet. App. 4a n.1. Looking only at Section 533(b)(1) and (2), the court agreed with the district court that the proper standard of review was "intermediate scrutiny," as most recently elaborated in *Turner Broadcasting System v. FCC*, 114 S. Ct. 2445 (1994). Pet. App. 16a-33a. In applying the standard, the court treated as wholly irrelevant this Court's unanimous ruling in *FCC v. National Citizens Committee for Broadcasting (NCCB)*, 436 U.S. 775 (1978), that the holder of a broadcast license could constitutionally be barred from being in the newspaper business in its broadcast service area. Pet. App. 18a-19a.[13]

Applying *Turner*, the Fourth Circuit agreed that the governmental interests in preventing "cross-subsidization" and "network-access discrimination" and "preserving di-

[13] The court mistakenly attributed to NCTA the view that *NCCB* calls for, and Section 533(b) should be subject to, mere rationality review. *See* Pet. App. 17a-20a. NCTA in fact urged that *NCCB*, though not expressly invoking any standard, supplied a "similar framework" to intermediate scrutiny. NCTA Ct. App. Reply Br. 1, 8; *see* NCTA Ct. App. Br. 13, 16.

versity of ownership of communications outlets and of the means of electronic access to homes and businesses" were unquestionably significant. *Id.* at 33a-34a. The court also took as a given "that ordinary regulatory oversight is insufficient to guard against telephone company use of cross-subsidization in the cable transport market" and that, *contrary* to the district court's "essential" rationale, telephone company entry into cable does in fact present greater economic problems than telephone company offering of (regulated) common carrier transmission service. *Id.* at 39a. Even so, the court of appeals concluded that the statute failed intermediate scrutiny.

The first problem, the court held, was that in the absence of factual findings by Congress (Pet. App. 35a, 39a) or a record of pre-1984 FCC consideration of "other, less drastic regulatory schemes" (*id.* at 40a), the court was "not convinced" that Section 533(b) is narrowly tailored to address the identified problems. *Id.* at 39a. The court cited one, and only one, " 'obvious less-burdensome alternative' " as the reason for its conclusion (*id.* at 41a): a rule requiring telephone companies to offer a fixed percentage of their channel capacity to independent programmers (coupled, presumably, with rules on cost accounting and other matters, enforced through administrative oversight). *Ibid.* The court did not offer an explanation, or citation to any evidence in the record, showing how—on the court's own assumption that "ordinary regulatory oversight is insufficient" (*id.* at 39a)—this alternative sufficiently protected against the evils targeted by Section 533(b) so as to justify upsetting Congress's judgment.

The second problem with Section 533(b), the court concluded, is that it does not "leave open ample alternative methods of communication." Pet. App. 43a. Without any reference to the "good cause" provision of Section 533(b)(4), the court characterized the statute as "bar[ring] absolutely the telephone companies from entering, with editorial discretion, the cable television market." *Id.* at 43a. The court did not dispute (or in some

instances recognize) that Bell Atlantic may offer video programming in various ways—for example, through its own or others' broadcast stations or its own or others' satellite or wireless cable service; through independent cable systems (by selling its programming, as other cable programmers do, or by using leased access, under 47 U.S.C. § 532); through the retail program packagers/providers on Bell Atlantic's own video network (see *Video Dialtone Reconsideration Order*, 10 F.C.C.R. 244, 280-01 (1994); *In re Time Warner Entertainment Co.*, 8 F.C.C.R. 7106 (1993)). The court stressed that, "unlike other video programmers, the telephone companies *cannot guarantee* that their programming will reach this audience." Pet. App. 13a-14a.

Both the Government and NCTA sought rehearing. Petitioner NCTA argued that the "good cause" waiver authority of Section 533(b)(4) was broad enough to allow for the very sort of "narrow tailoring" of restrictions on telephone company provision of video programming that would avoid the substantial constitutional problems that the Fourth Circuit found present in the basic cross-ownership bar (paragraphs (1) and (2)) when read in isolation from the waiver authority.[14] The Government was silent, however, on the proper construction of the waiver provision of this statute that it is charged with administering. The court of appeals denied rehearing on January 18, 1995. Pet. App. 94a-97a.

III. Subsequent Agency Action.

Two days after rehearing was denied, the Commission released an order tentatively proposing the "saving" construction of the "good cause" waiver provision that the Fourth Circuit had just passed over without comment. *See* Pet. App. 98a-102a. The Commission explained that

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[14] Prompted by a new Ninth Circuit ruling, *GTE California, Inc. v. FCC*, 39 F.3d 940, 946 (1994), NCTA had briefly raised this issue in a letter to the Fourth Circuit one week before the Fourth Circuit's decision.

"good cause" ordinarily refers to "changed circumstances" and that circumstances in the cable industry—"no longer a fledgling industry"—had changed dramatically. *Id.* at 99a. Moreover, if regulatory safeguards designed to address the economic dangers underlying the statute were fashioned, compliance with those safeguards as a condition of a waiver would "constitute 'particular circumstances . . . , taking into account the policy' of Section 533(b)." Pet. App. 100a. In the Commission's view, then, the "good cause" waiver provision, previously overlooked in the analysis of Section 533(b), should be construed to narrow the cross-ownership rule so as to "render Section 533(b) constitutional." *Id.* at 101a. The Commission solicited comments on this proposed interpretation.

In light of this new agency action, the Government immediately began suggesting to the several courts of appeals in which cases on the validity of Section 533(b) were pending that the cases be held in abeyance until the Commission received the requested comments and made a final decision on adoption of the proposed reading of Section 533(b)(4). *See, e.g.*, Appellants' Petition for Rehearing at 12-14, *US West, Inc. v. United States*, No. 94-35775 (9th Cir.); Appellants' Petition for Rehearing at 2, *Pacific Telesis Group v. United States*, No. 94-16064 (9th Cir.); Brief for the Appellants at 51-52, *BellSouth Corp. v. United States*, No. 94-7036 (11th Cir.); Initial Brief for Appellants at 41-43, *Ameritech Corp. v. United States*, No. 95-1223 (7th Cir.); Brief for the Appellants at 39-41, *Nynex Corp. v. United States*, No. 95-1183 (1st Cir.). On May 16, 1995, the Commission adopted this construction of Section 533(b)(4). *See* Pet. App. 103a-122a.[15]

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[15] Meanwhile, Congress is considering telecommunications legislation that, among many other things, would replace Section 533(b) with narrower constraints on telephone company entry into the cable business.

REASONS FOR GRANTING THE PETITION

The court of appeals in this case has invalidated an Act of Congress that directly affects the entire local telephone and cable television industries and the customers they serve. The decision of the Fourth Circuit upholds an injunction that itself covers the full multi-state service area of one of the seven Regional Bell Operating Companies—substantially equivalent to the territory embraced by the Third, Fourth, and D.C. Circuits. Similar decisions raising the very same issue have now extended the invalidation of the federal statute to essentially the whole Nation. The sheer importance of the issue to businesses and consumers is, we believe, reason enough for not allowing the Fourth Circuit decision to stand.[16]

The mistakes made by the court of appeals in its invalidation of Section 533(b) furnish additional reason. For one thing, the decision is inconsistent with the cardinal principle that a statute should be construed, where fairly possible, to avoid constitutional difficulties. A proper reading of the "good cause" waiver provision of Section 533(b)(4), previously neglected in the analysis of the case, fulfills that obligation by legitimately curtailing the reach of the statute: the construction that the Commission now has adopted would allow Bell Atlantic to offer its video programming on its in-region

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[16] Each of the Regional Bell Operating Companies has received an injunction preventing enforcement of Section 533(b) against it, all without consideration of the (new) "good cause" issue. *See US WEST, Inc. v. United States*, 48 F.3d 1092 (9th Cir. 1994), rehearing pending; *Pacific Telesis Group v. United States*, 48 F.3d 1106 (9th Cir. 1994), rehearing pending; *Ameritech Corp. v. United States*, 867 F. Supp. 721 (N.D. Ill. 1994), appeal pending; *Bellsouth Corp. v. United States*, 868 F. Supp. 1335 (N.D. Ga. 1994), appeal pending; *NYNEX Corp. v. United States*, No. 93-323 (D. Me. Dec. 8, 1994), appeal pending; *Southwestern Bell Corp. v. United States*, No. 3-94CV-0193-D (N.D. Tex. Mar. 27, 1995). *See also, e.g., United States Tel. Ass'n v. United States*, No. 1:94CV1961 (D.D.C. Feb. 14, 1995), appeal pending; *GTE South, Inc. v. United States*, No. 94-1588 (E.D. Va. Jan. 13, 1995), appeal pending; *Southern New England Tel. Co. v. United States*, No. 3:94CV-90 (D. Conn. Apr. 28, 1995).

network under proper regulatory safeguards, thereby removing both grounds for the Fourth Circuit's invalidation of Section 533(b) as it misconstrued the provision. This Court should either remand for the Fourth Circuit to give full consideration to this "saving" construction or grant review to correct the court of appeals' unnecessary invalidation of this Act of Congress.

Review would be warranted even if Section 533(b)(4) had not been misconstrued (though correcting that misconstruction would eliminate any need to rule on other issues). The court of appeals properly undertook a careful and searching examination of the justification for Section 533(b) under the "intermediate scrutiny" standard of review, but ultimately it overstepped the bounds of independent judicial scrutiny of federal legislation. The court simply had an insufficient basis for insisting that the important dangers targeted by Congress in Section 533(b) *must* be addressed, not by a rule of structural separation, but by regulatory safeguards enforced by administrative oversight, whose effectiveness in the present context Congress could reasonably judge inadequate. The court likewise erred in deeming the restriction of local telephone companies' ability to speak too great, with no regard whatever for this Court's ruling in *NCCB* that the holder of a broadcast license (as long as it retains that license) may constitutionally be barred from publishing a newspaper in its community. Given the increasing importance of intermediate scrutiny, the Fourth Circuit's decision, unless corrected, will set an influential precedent for the application of First Amendment standards to a wide range of regulations of speech businesses.

I. This Court repeatedly has stressed that "a statute is to be construed where fairly possible so as to avoid substantial constitutional questions." *United States v. X-Citement Video, Inc.*, 115 S. Ct. 464, 467 (1994). *See id.* at 472 (where a statutory construction "would raise serious constitutional doubts[,] [i]t is . . . incumbent upon us to read the statute to eliminate those doubts so

long as such a reading is not plainly contrary to the intent of Congress").[17] This principle is rooted in the constitutional respect owed to Congress by the Judicial Branch. It therefore imposes an independent duty on the courts—applicable even in a case, like the present, where the parties themselves overlooked the issue of a saving construction until well into the proceeding. *Cf. Jean v. Nelson*, 472 U.S. 846, 854-55 (1985) (applying rule although both sides, including Government, continued to press for constitutional ruling); *cf. X-Citement Video, supra* (applying rule where Government urged saving construction for the first time in Supreme Court).

The principle applies in this case. The Fourth Circuit found that serious (in the court's view, debilitating) constitutional doubts are raised by the cross-ownership bar set forth in Section 533(b)(1) and (2). Those difficulties rest on the judgment that a flat cross-ownership bar is too ill-fitting a way of addressing the real risks of monopoly abuse underlying the bar, *i.e.*, that there is insufficient justification for not attacking the problem through regulatory standards and that too much speech is foreclosed by forbidding direct in-region wire-delivered video service. Both of those difficulties would be avoided, however, by allowing a telephone company to provide video programming on its own network under regulatory safeguards tailored to the underlying risks. And a construction of Section 533(b) that permits just such a result *is* "fairly possible" and is "not plainly contrary to the intent of Congress." *X-Citement Video*, 115 S. Ct. at 467, 472.

The standard of "good cause" in Section 533(b)(4) is readily construed to authorize a waiver upon compliance with regulatory safeguards that address the economic

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[17] *See, e.g., Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988); *NLRB v. Catholic Bishop of Chicago*, 440 U.S. 490, 499-501 (1979); *International Ass'n of Machinists v. Street*, 367 U.S. 740, 749-50 (1961); *Crowell v. Benson*, 285 U.S. 22, 62 (1932); *Murray v. The Schooner Charming Betsy*, 6 U.S. (2 Cranch) 64, 118 (1804).

dangers underlying the general cross-ownership rule while reflecting any material changes of circumstances since adoption of the rule, *i.e.*, changes affecting the policy balance of risks and benefits. "Good cause" is commonly interpreted to refer to materially changed circumstances,[18] and a waiver based on new circumstances, if the changes alter the relevant policy balance, would be "justified by the particular circumstances demonstrated by the [telephone company], taking into account the policy of this subsection." Section 533(b)(4).[19] Under the standards of intermediate scrutiny applied by the Fourth Circuit, a properly crafted set of safeguards fitted to the concededly substantial governmental interests underlying the statute would, necessarily, eliminate the constitutional issues. *See* Pet. App. 115a. This reading of Section 533(b)(4), in brief, avoids the constitutional problems and, as a textual and common-sense matter, is at least "fairly possible." *X-Citement Video*, 115 S. Ct. at 467.[20]

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[18] *See, e.g., Illinois v. ICC*, 713 F.2d 305, 310 (7th Cir. 1983); *Greyhound Corp. v. ICC*, 668 F.2d 1354, 1362 (D.C. Cir. 1981).

[19] Section 533(b)(4) also states that waivers are to be "made in accordance with" the FCC's cross-ownership *regulation* in effect on Sept. 20, 1984. 47 U.S.C. § 533(b)(4). That regulation, like the statute, identified "good cause" as an independent basis for a waiver.

[20] This construction cannot be rejected based on this Court's holding in *MCI Telecommunications Corp. v. AT&T*, 114 S. Ct. 2223 (1994), that a provision authorizing the Commission to "modify" tariff-filing requirements in "special circumstances" did not allow wholesale abrogation of the general rule. First, the principle requiring avoidance of serious constitutional issues, which significantly alters the interpretive calculus, played no role whatever in *MCI*. Second, the relevant statutory text in *MCI* was importantly different from the text here. The *MCI* decision rested overwhelmingly on the restrictive meaning of the word "modify" in the statute there (*id.* at 2229-32); that word is nowhere found in Section 533(b)(4), which instead uses the broad term "waive." And unlike the "special circumstances" language at issue in *MCI*, the "particular circumstances" language in Section 533(b)(4)

This reading also is "not plainly contrary to the intent of Congress." *Id.* at 472. Whatever the precise reach of the congressional judgment made in 1984, nothing in the "sparse" legislative history (Pet. App. 53a) reveals a clear judgment to preclude Commission waiver if, in the district court's words, "the rapidly changing nature of the telecommunications field has caused the rationale supporting the [presumptive bar in the] statute to evolve over time." Pet. App. 81a. The Commission has identified several changes relevant to the cost-benefit policy balance underlying the presumptive bar: on the risk-of-entry side, cable is no longer a "fledgling" industry; on the benefits-of-entry side, there are new imperatives for development of new technologies and potential benefits from fair competition in the video market. Pet. App. 99a-100a, 112a-113a; *Video Dialtone Order*, 7 F.C.C.R. at 5844-45, 5848-49. There is no clear evidence that Congress foreclosed the Commission's ability to assess changing conditions to determine whether telephone entry under proper safeguards had come to serve the stated goal of "encourag[ing] a diversity of ownership of communications outlets." H.R. Rep. 934, *supra*, at 55. Thus, if changes in relevant circumstances can be found so seriously to loosen the fit between the cross-ownership bar and the risks it addresses as to raise a serious question of the measure's constitutionality, those same changes ought to constitute good cause for a waiver that avoids the constitutional concerns with Section 533(b).[21]

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does not appear as a restriction in the sentence granting waiver *authority* to the Commission, but only in the sentence setting the terms for *mandatory* waivers. Of course, "good cause," as the Commission proposes to construe it, would not freely allow entry into cable, but would impose specific conditions. *See* Pet. App. 100a, 117a.

[21] The Ninth Circuit adverted to the possibility of such a saving construction in *GTE California, Inc. v. FCC*, *supra*. *See* Pet. App. 99a, 121a. In addition, this construction is consistent with the conclusion of the D.C. Circuit in *NCTA v. FCC*, 914 F.2d 285 (D.C. Cir. 1990), that the "good cause" basis for

It would be appropriate for the Court to grant the petition, vacate the Fourth Circuit decision, and remand the case for reconsideration in light of the newly developed argument about Section 533(b)(4). Although the issue was technically placed before the court of appeals, there is every reason to think that the Fourth Circuit gave it less than plenary consideration: unaided by the parties, the court initially misread Section 533(b)(4), overlooking its "good cause" standard (*see* Pet. App. 4a n.1); and while the issue was briefly raised prior to decision, an argument based on the provision was not developed until rehearing, and even then, not by the Commission, the agency charged with administering the statute. The Commission was not able to complete its process of releasing a notice of proposed rulemaking on the subject until two days *after* rehearing was denied. *See* page 15, *supra*. And the Commission now has finally adopted the new construction, which amounts to a change in the applicable law under familiar administrative-law principles. This is an important development that the Fourth Circuit should be given a full initial opportunity to consider.

Otherwise, an outright grant of the petition is warranted. At present, an important Act of Congress has been struck down based on an erroneous construction of the Act and without any consideration of the merits of a significant argument in favor of the Act's constitutionality. That result should not stand.

II. Even aside from overlooking the narrowing function served by a proper construction of "good cause," the Fourth Circuit committed other important errors in reaching its decision. The "intermediate scrutiny" of *Turner*

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waivers under Section 533(b)(4) focuses on whether "the advantages to be derived from [the telephone company's] application cannot be realized in the absence of a waiver" (*id.* at 289), for the advantages may include the technological and competitive benefits the Commission has cited in supporting telephone company entry into the cable business. Pet. App. 100a, 112a-113a.

and its precursors, applied with a searching focus on the justifications for the law, is the proper standard for review. But the court of appeals drew improper conclusions at each of the two steps—narrow tailoring and alternative means of communication—where it found fault with Section 533(b).

A. A statute is "narrowly tailored" to serve government interests if it does not "burden substantially more speech than is necessary to further the government's legitimate interests." *Ward v. Rock Against Racism*, 491 U.S. 781, 799 (1989); *see Turner*, 114 S. Ct. at 2469. And the effectiveness with which alternative means would serve those interests is a part of the assessment: the law satisfies the narrow-tailoring requirement if it " 'promotes a substantial government interest that would be achieved less effectively absent the regulation.' " *Ward*, 491 U.S. at 799 (quoting *United States v. Albertini*, 472 U.S. 675, 689 (1985)). The Fourth Circuit, pointing to precisely one regulatory alternative to Section 533(b), simply gave no sound basis for concluding that the statute's structural separation fails the "narrow tailoring" standard.

The court of appeals did not question the well-documented reality of the economic problems addressed by Section 533(b). *Compare Turner*, 114 S. Ct. at 2470-71 (serious question about the reality of the underlying alleged problem of threat to broadcasting system). Still regulated monopolies (Pet. App. 67a; *United States v. Western Electric Co.*, 993 F.2d 1572, 1578 (D.C. Cir.), *cert. denied*, 114 S. Ct. 487 (1993)), the local telephone companies have powerful incentives to use entry into the cable business, which presents vast opportunities for shared costs (*e.g.*, the costs of a joint voice-video network), to exploit telephone ratepayers and to forestall the threat to the telephone monoply that the cable network presents as the "second wire" for electronic communications.[22] In reaching its decision, moreover, the Fourth

[22] The Fourth Circuit did not dispute that telephone rate regulation, though modified in recent years to move away from the

Circuit *accepted* that the targeted economic harms are more likely to occur if telephone companies can enter the cable business than if they are restricted to the regulated transmission business, thus refusing to adopt the sole basis of the district court's decision. Pet. App. 39a. As the record on summary judgment shows, a transmission monopoly is more valuable to Bell Atlantic (which is therefore more likely to seek it) if it can be used to exploit the retail cable market than if its value is limited to the lesser profits available in the (more heavily regulated) transmission market. *See* Ct. App. JA 357-58 (Owen Reply Aff. ¶¶ 3-4); *National Rural Telecom Ass'n v. FCC*, 988 F.2d at 180-81; *US West, Inc.*, 48 F.3d at 1102 (evidence sufficient on this point).

Likewise, the Fourth Circuit did not question the *scope* of the problems targeted by Section 533(b), because the economic problems are endemic to regulated monopolies like the local telephone companies. *Compare Turner, supra* (any threat to broadcasting may vary from market to market). Nor did the Fourth Circuit express any reason to be suspicious that any contest among political interest groups or other political influences were at play to raise suspicion about the existence of a legitimate policy basis for the law at issue. *Compare Turner, supra* (pitting politically influential broadcasters against cable interests); *Sable Communications of Cal., Inc. v. FCC*, 492 U.S. 115 (1989) ("dial-a-porn" politics). The familiar problem addressed in the law was amply supported in law and telephone-company history and not greatly controversial; indeed, the telephone companies themselves *accepted* the law. *See* page 9, *supra*.

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most traditional form of strict rate-of-return regulation, still is generally tied to costs in substantial measure: nothing in the record suggests that "pure" price cap regulation has been adopted either by the FCC or generally (if anywhere) by the States. Nor did the courts below question that the structural conditions for the economic problem targeted by Congress—differential price regulation or demand elasticities—are present for telephone and cable service. *See* Ct. App. JA 289 (Owen Aff.).

The basis for the Fourth Circuit's decision, instead, was its view that Congress had to rely on conduct-specific regulatory checks and administrative oversight as an adequate solution to the problem targeted by the statute. *Compare* Pet. App. 39a, 91a & n.34 (assuming regulatory inadequacy). But in a case like this one, that judgment should require strong support for the *unreasonableness* of the opposite view—that regulatory checks are not adequate to achieve the congressional aim. This is not a case like *Sable, supra*, which involved strict scrutiny of a content-based law against the background of good reasons to suspect the lack of a dispassionate congressional assessment of regulatory effectiveness. Here, Congress cannot be bound to accept a regulatory agency's optimistic evaluation of its own abilities, especially when such an evaluation is contradicted by reports of the independent congressional investigatory arm (the General Accounting Office) explicitly questioning the effectiveness of regulatory solutions. *See* GAO, *Telephone Communications: Controlling Cross-Subsidy Between Regulated and Competitive Services* (Oct. 1987); GAO, *Telecommunications: FCC's Oversight Efforts to Control Cross-Subsidization* (Feb. 1993).

In any event, it is impossible to question the *reasonableness* of a judgment deeming insufficiently effective any realistic program of administrative oversight of cost allocations and other economic decisions on innumerable transactions involving billions of dollars in complex technology and ever-changing markets, if the economic incentives for harmful conduct are present, as they are under the Fourth Circuit's single alternative of capacity-use restrictions on the telephone companies. Limits on resources are a problem, but the absence of any clear standards and the complexity of the regulatory task are even deeper problems.[23] The effectiveness of regulatory

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[23] *See, e.g., Permian Basin Area Rate Cases*, 390 U.S. 747, 804 (1968) ("There is ample support for the Commission's judgment that the apportionment of actual costs between two jointly produced commodities, only one of which is regulated by the Com-

review of the internal workings of *speech* businesses is also subject to limitation because of the legitimate government interest in avoiding the "serious independent difficulties" presented under the First Amendment by such a "problematic degree of governmental entanglement." L. Tribe, *American Constitutional Law* § 11-5, at 784 (2d ed. 1988). In the end, as Bell Atlantic and the Bell Operating Companies explained to the D.C. Circuit, the choice between barring their entry into an adjacent unregulated business or allowing entry subject to regulatory oversight "involves multi-faceted *policy judgments* based on market analysis, administrative experience, enforcement priorities, economic policy, and a complex balancing of competitive risks and benefits; these judgments are not simple findings of fact or even applications of law to fact." Brief of the Bell Company Appellees at 50, *United States v. Western Electric*, No. 91-5263 (D.C. Cir. Aug. 17, 1992). The Fourth Circuit could not properly make its own intuitive policy judgment on this subject the basis for invalidating a congressional enactment.

B. If Section 533(b) is narrowly tailored to serve the unquestionably important governmental interests—that is,

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mission, is instrinsically unreliable." (footnote citing sources omitted)); *Justice Department Merger Guidelines* § 4.23 n.35 (referring to "insoluble cost allocation problem"); *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 27 (1st Cir. 1990), *cert. denied*, 499 U.S. 931 (1991) ("Accounting systems for allocating investment between different services or customer classes are notoriously complicated and sometimes arbitrary.") (quoting sources); M. Kellogg, P. Huber, & J. Thorne, *supra*, § 3.2.4, at 144 ("Certainly, the allocation of costs between closely related and interdependent businesses is an essentially arbitrary exercise; many economists therefore take cross-subsidy concerns very seriously. Cross-subsidy is of greatest concern when there are important common or joint costs among regulated and unregulated businesses—costs that cannot be clearly attributed to one business or the other."); *id.* § 9.3.4, at 437 ("common costs do create enormous opportunities for accounting hanky-panky"); page 6, *supra* (FCC study in 1981).

if other means would not be as effective in protecting those interests—it is not clear what independent weight would attach to the Fourth Circuit's view, were it correct, that Section 533(b) also has too great an impact on Bell Atlantic's opportunities for speech. That view, however, is itself flawed. The court took too narrow a view of the opportunities that Bell Atlantic has to reach its desired (in-region) video customers under Section 533(b)(1) and (2). The court also took too narrow a view of the legal standards for judging the sufficiency of those opportunities.

Bell Atlantic may develop programming to offer to a local cable system or to a local broadcaster or satellite service or wireless cable service (or even a video store). As far as Section 533(b) is concerned, Bell Atlantic may even become a broadcaster or itself offer direct broadcast satellite service (DBS) or wireless cable service (MMDS).[24] Bell Atlantic also may develop entire packages of programming and contract to supply the content for any of the programmer-retailers who will be dealing directly with subscribers on the Bell Atlantic "video dialtone" network. *See* Bell Atlantic Ct. App. Br. 74 ("hundreds or thousands" of channels on network). *See also* 47 U.S.C. § 532 (leased access). In these respects, Bell Atlantic is in a comparable position to that of cable programmers today who do not own or control their own cable systems. *Compare* Pet. App. 13a-14a. Thus, in precisely barring the in-region *retailing* of *wire*-delivered video programming, Section 533(b)(1) and (2) leave significant alternative means by which Bell Atlantic can reach in-region customers with its video programs.

In judging Section 533(b)(1) and (2) unduly limiting, the Fourth Circuit not only ignored several of the

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[24] Bell Atlantic has in fact recently taken a large stake in an MMDS operator. *See Bell Atlantic to Shift to 'Wireless Cable' TV*, Wash. Post, May 17, 1995, at F1; *RBOCS Pump $100 Million Into Wireless Cable Firm, Spurring Consolidation*, Communications Daily, Mar. 30, 1995, at 1.

channels of communication just mentioned, but also disregarded the central precedent for judging the legal significance of the opportunities for speech left unrestricted to Bell Atlantic. The Fourth Circuit simply dismissed the relevance of this Court's decision in *NCCB* on the ground that "the regulation there at issue affected ownership *of the broadcast media*" and "the instant case does not involve regulation of the broadcast media." Pet. App. 19a (emphasis in original, footnote omitted). These statements accurately describe a distinction, but they furnish no explanation of why the distinction matters under the First Amendment.

In fact, *NCCB* is powerfully relevant, for if *NCCB* is a "broadcaster" case, this is a "common carrier telephone" case, and broadcasters have, if anything, *greater* First Amendment rights than common carriers. *See FCC v. League of Women Voters*, 468 U.S. 364, 387 (1984). Applying a standard comparable to intermediate scrutiny (though not invoking any specific standard), the Court in *NCCB* squarely held that, in order to achieve diversity of local media ownership, the government could constitutionally impose a flat ban that prohibited the holder of a broadcast license, as long as it retained that license, from entering the most venerable of protected speech businesses (newspaper publishing) in its service area; the alternatives left to the broadcaster by this valid prohibition were non-newspaper speech in-region plus all forms of speech out-of-region. *NCCB*, 436 U.S. at 794-802.[25] It is hard to see why the holder of a common carrier telephone franchise, as long as it holds that franchise, may not for similar diversity-of-ownership reasons (justified under narrow tailoring) be barred from entering the cable business in-region—or why unrestricted opportunities for out-of-region speech plus non-cable in-region speech are not sufficient. If entry into a protected speech business (newspaper publishing or cable) may be condi-

[25] *See also Marsh Media Ltd. v. FCC*, 798 F.2d 772 (5th Cir. 1986), *cert. denied*, 479 U.S. 1085 (1987) (upholding cable-broadcast cross-ownership rule).

tioned on foregoing participation in a *speech* business (broadcasting), the First Amendment impact is smaller, not greater, when the condition imposed is foregoing participation in a non-speech business (telephone common carriage). The Fourth Circuit thus erred in disregarding *NCCB* in this case.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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May 18, 1995

APPENDICES

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS, FOURTH CIRCUIT

Nos. 93-2340, 93-2341

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA; BELL ATLANTIC VIDEO SERVICES COMPANY; BELL ATLANTIC CORPORATION; CHESAPEAKE AND POTOMAC TELEPHONE COMPANY; C & P TELEPHONE COMPANY OF MARYLAND; THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF WEST VIRGINIA; THE DIAMOND STATE TELEPHONE COMPANY; THE BELL TELEPHONE COMPANY OF PENNSYLVANIA; NEW JERSEY BELL TELEPHONE COMPANY,
Plaintiffs-Appellees,

v.

UNITED STATES OF AMERICA; FEDERAL COMMUNICATIONS COMMISSION; JANET RENO, in her official capacity as Attorney General of the United States,
Defendants-Appellants,

and

THE NATIONAL CABLE TELEVISION ASSOCIATION, INCORPORATED,
Defendant.

CONSUMER FEDERATION OF AMERICA; VIRGINIA CITIZENS CONSUMER COUNCIL; NEWSPAPER ASSOCIATION OF AMERICA; VIRGINIA PRESS ASSOCIATION; COMPUTER & COMMUNICATIONS INDUSTRY ASSOCIATION; METS FANS UNITED/VIRGINIA CONSUMERS FOR CABLE CHOICE, ET AL.; CITIZENS FOR A SOUND ECONOMY FOUNDATION; THE AMERICAN LEGISLATIVE EXCHANGE COUNCIL; THE COMPETITIVE ENTERPRISE INSTITUTE;

THE UNITED STATES TELEPHONE ASSOCIATION; AMERITECH CORPORATION; BELLSOUTH CORPORATION; GTE SERVICE CORPORATION, on behalf of its affiliated domestic operating companies; NYNEX CORPORATION; PACIFIC TELESIS GROUP; ROCHESTER TELEPHONE CORPORATION; SOUTHWESTERN BELL CORPORATION; US WEST INCORPORATED; TELECOMMUNICATIONS INDUSTRY ASSOCIATION, FIBER OPTICS DIVISION,

Amici Curiae.

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA; BELL ATLANTIC CORPORATION; BELL ATLANTIC VIDEO SERVICES COMPANY; CHESAPEAKE AND POTOMAC TELEPHONE COMPANY; THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF MARYLAND; THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF WEST VIRGINIA; THE DIAMOND STATE TELEPHONE COMPANY; THE BELL TELEPHONE COMPANY OF PENNSYLVANIA; NEW JERSEY BELL TELEPHONE COMPANY,

Plaintiffs-Appellees,

v.

THE NATIONAL CABLE TELEVISION ASSOCIATION, INCORPORATED,

Defendant-Appellant,

and

UNITED STATES OF AMERICA; FEDERAL COMMUNICATIONS COMMISSION; JANET RENO, in her official capacity as Attorney General of the United States,

Defendants.

CONSUMER FEDERATION OF AMERICA; VIRGINIA CITIZENS CONSUMER COUNCIL; NEWSPAPER ASSOCIATION OF AMERICA; VIRGINIA PRESS ASSOCIATION; COMPUTER & COMMUNICATIONS INDUSTRY ASSOCIATION;

METS FANS UNITED/VIRGINIA CONSUMERS FOR CABLE CHOICE, ET AL.; CITIZENS FOR A SOUND ECONOMY FOUNDATION; THE AMERICAN LEGISLATIVE EXCHANGE COUNCIL; THE COMPETITIVE ENTERPRISE INSTITUTE; THE UNITED STATES TELEPHONE ASSOCIATION; AMERITECH CORPORATION; BELLSOUTH CORPORATION; GTE SERVICE CORPORATION, on behalf of its affiliated domestic operating companies; NYNEX CORPORATION; PACIFIC TELESIS GROUP; ROCHESTER TELEPHONE CORPORATION; SOUTHWESTERN BELL CORPORATION; US WEST INCORPORATED; TELECOMMUNICATIONS INDUSTRY ASSOCIATION, FIBER OPTICS DIVISION,
Amici Curiae.

Argued Feb. 7, 1994.

Decided Nov. 21, 1994.

Before RUSSELL and MICHAEL, Circuit Judges, and TILLEY, United States District Judge for the Middle District of North Carolina, sitting by designation.

Affirmed by published opinion. Judge RUSSELL wrote the opinion, in which Judge TILLEY joined. Judge MICHAEL wrote a separate opinion concurring in part and concurring in the judgment.

OPINION

DONALD RUSSELL, Circuit Judge:

At issue in this case is the constitutionality of 47 U.S.C. § 533(b), which provides, in pertinent part:

> (1) It shall be unlawful for any common carrier, subject in whole or in part to subchapter II of this chapter, to provide video programming directly to subscribers in its telephone service area, either di-

> rectly or indirectly through an affiliate owned by, operated by, controlled by, or under common control with the common carrier.
>
> (2) It shall be unlawful for any common carrier, subject in whole or in part to subchapter II of this chapter, to provide channels of communication or pole line conduit space, or other rental arrangements, to any entity which is directly or indirectly owned by, operated by, controlled by, or under common control with such common carrier, if such facilities or arrangements are to be used for, or in connection with, the provision of video programming directly to subscribers in the telephone service area of the common carrier.

47 U.S.C. § 533(b)(1), (2).[1] This provision, enacted as part of the Cable Communications Policy Act of 1984 (the "1984 Cable Act"), Pub.L. No. 98-549, 98 Stat. 2779 (codified at 47 U.S.C. § 521 *et seq.*), essentially prohibits local telephone companies from offering, with editorial control, cable television services to their common Carrier subscribers.[2] In a thorough opinion, the district court found the statute to violate the First Amendment. *Chesapeake & Potomac Tel. Co. v. United States*, 830 F.Supp. 909 (E.D.Va.1993) ("*C & P*").[3] For the reasons stated herein, we affirm.

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[1] Paragraph (3) provides that Section 533(b) does not apply to a common carrier to the extent that the common carrier provides service to "any rural area." Paragraph (4) confers upon the FCC the discretionary authority to grant waivers from paragraphs (1) and (2) where the FCC determines that local common carrier subscribers could not obtain cable services other than by means of the common carrier. Neither of these paragraphs is implicated here.

[2] *See infra* Section III.

[3] The federal district courts in *Ameritech Corp. v. United States*, 867 F.Supp. 721 (N.D.Ill.1994), and *US West, Inc. v. United States*, 855 F.Supp. 1184 (W.D.Wash.1994), reached the same conclusion. Similar litigations are at various stages in other district courts. *See, e.g., NYNEX Corp. v. FCC*, 153 F.R.D. 1 (D.Me.1994) (per-

I.

The facts and background underlying this case, which the parties do not dispute, are presented fully in the opinion of the district court. We summarize them here.

Chesapeake and Potomac Telephone Company of Virginia ("C & P") applied for a cable franchise from the City of Alexandria ("City"). It is undisputed that the City denied this application solely upon its belief that any grant of such a franchise would violate 47 U.S.C. § 533 (b). Thereafter, C & P and Bell Atlantic Video Systems, both wholly-owned subsidiaries of Bell Atlantic Corporation, brought suit in federal district court in Virginia against the United States, the Federal Communications Commission ("FCC") and the Attorney General (collectively the "Government defendants") seeking to invalidate Section 533(b) as itself violative of the First Amendment and seeking to enjoin its enforcement.[4] Subsequently, the National Cable Television Association ("NCTA") sought, and was granted, permission to intervene as a defendant. Cross-motions for summary judgment were filed. Ultimately, the district court granted plaintiffs' motion for summary judgment. It declared 47 U.S.C. § 533(b) unconstitutional both facially and as applied to plaintiffs and enjoined the Government defendants from enforcing the provision.[5]

The Government defendants and the NCTA appeal the district court's judgment.

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mitting regional cable television association to intervene in action challenging Section 533(b)).

[4] That the statute, by its terms, would apply to bar C & P from operating a cable system in Alexandria is undisputed. C & P provides common carrier service in Alexandria, and so plaintiffs could not operate a cable system servicing customers in Alexandria without running afoul of Section 533(b)(1).

[5] In its original Order, dated August 24, 1993, the district court declared unconstitutional "47 U.S.C. § 533." By Amended Final Order dated October 7, 1993, the district court amended its Order limiting the invalidation to Section 533*(b)*.

II.

Before the specific contentions of the parties are addressed, a discussion, albeit truncated, of the history of regulation in this area will be helpful.

Although cable television has its origins in the 1940's, *see Turner Broadcasting Sys., Inc. v. FCC*, —— U.S. at ——, ——, 114 S.Ct. 2445, 2451, 129 L.Ed.2d 497 (1994), only by the late 1960's was the industry on the verge of true expansion, *see C & P*, 830 F.Supp. at 915. In those days, it was commonplace for companies to hang the coaxial cables through which they provided cable service or, as it was then called, community antenna television service ("CATV"), from utility poles. The FCC was concerned that local telephone companies, as monopolists and owners of these poles, would be in a position to obstruct or delay companies which were unaffiliated with the telephone companies, and who wished to provide cable television services, from entering that market. The FCC's initial response to this concern consisted solely of a requirement that a telephone company obtain certification, pursuant to 47 U.S.C. § 214,[6] prior to constructing, acquiring or operating any video transmission facilities. *See General Tel. Co. of Cal.*, 13 F.C.C.2d 448 (1968), *aff'd*, 413 F.2d 390 (D.C.Cir.), *cert. denied*, 396 U.S. 888, 90 S.Ct. 173, 178, 24 L.Ed.2d 163 (1969). The FCC found that anticompetitive practices by telephone companies against un-

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[6] That measure provides:

> No carrier shall undertake the construction of a new line or of an extension of any line, or shall acquire or operate any line, or extension thereof, or shall engage in transmission over or by means of such additional or extended line, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require the construction, or operation, or construction and operation, of such additional or extended line. . . .

47 U.S.C. § 214(a).

affiliated cable companies nevertheless persisted and, so, in 1970, the FCC promulgated a rule which barred telephone companies from providing cable service in their local telephone service areas, except upon issuance of a waiver by the FCC. That rule, then found at 47 C.F.R. § 64.601, provided, in pertinent part:

> (a) No telephone common carrier subject in whole or in part to the Communications Act of 1934, as amended, shall directly or indirectly through an affiliate owned or controlled by or under common control with said telephone communications common carrier, engage in the furnishing of CATV to the viewing public in its telephone service area.
>
> (b) No telephone common carrier subject in whole or in part to the Communications Act of 1934, as amended, shall provide channels of communications or pole line, conduit space, or other rental arrangements, to any entity which is directly or indirectly owned, operated, or controlled by such telephone communications common carrier, where such facilities or arrangements are to be used for or in connection with the provision of CATV service to the viewing public in the service area of the said telephone common carrier.

Applications of Telephone Cos. for Section 214 Certificates for Channel Facilities Furnished to Affiliated Community Antenna Television Systems; Final Report and Order, 21 F.C.C.2d 307, Appendix A, at 331, *reconsidered in part*, 22 F.C.C.2d 746 (1970), *aff'd sub nom. General Tel. Co. of the Southwest v. United States*, 449 F.2d 846 (5th Cir.1971). (The rule, modified only so as to conform to Section 533(b), as discussed *infra*, is today found at 47 C.F.R. § 63.54.) In enacting the rule, the FCC specifically noted that concentration of control of communications media was undesirable. *Id.* ¶ 56. The FCC identified two ways in which local telephone companies, absent regulation, were likely to dominate the

cable industry. First, the telephone companies could deny unaffiliated cable companies access, or charge excessive prices for access, to telephone company poles. *Id.* ¶¶ 13(b), 46. (This is called "pole-access discrimination.") Second, the telephone companies with cable affiliates could subsidize these cable affiliates with revenue obtained from telephone company operations. *Id.* ¶ 13 (a). (This is called "cross-subsidization.")

In 1978, Congress passed the Pole Attachment Act, Pub.L. No. 95-234, 92 Stat. 35, which, in pertinent part, instructed the FCC to "regulate the rates, terms, and conditions for pole attachments," 47 U.S.C. § 224(b)(1). (The FCC subsequently promulgated regulations, *see* 47 C.F.R., Part 1, Subpart J, governing the rates, terms, and conditions for pole attachments.) While the Pole Attachment Act eliminates the possibility of discriminatory pricing for access to poles, it does not mandate access to poles and therefore does not address all the concerns purportedly addressed by the FCC rule and the subsequent enactment of Section 533(b).

In 1981, the FCC reconsidered the need for its cross-ownership rule. It concluded that the rule, at the time, remained a necessity, FCC Office of Plans and Policy, *FCC Policy on Cable Ownership: A Staff Report* 176 (1981), but acknowledged that it might not be necessary to retain the rule in perpetuity, *id.* at 177-78.

In 1984, Congress enacted Section 533, captioned "Ownership restrictions," as part of the 1984 Cable Act. The new statutory provision was adopted, with few changes, from the FCC rule. Importantly, however, and without explanation in the legislative history, Congress drafted Section 533(b) to prohibit not the furnishing of "CATV" service as did the extant FCC rule but, instead, the provision of "video programming." The FCC subsequently amended its regulation to reflect the enactment of Section 533(b).

Section 533(b)'s telephone-cable cross-ownership bar[7] was accompanied by Section 533(a)'s broadcasting-cable cross-ownership bar.[8] Subsection (c) grants the FCC authority to promulgate other media-related cross-ownership bars applicable to "ownership or control of a [local] cable system." Congress indicated, within the body of the statute, that it intended the 1984 Cable Act to "assure that cable communications provide and are encouraged to provide the widest possible diversity of information sources and services to the public," 47 U.S.C. § 521(4), and to "promote competition in cable communications," *id.* § 521(6). A House Report recited that the congressional aim in enacting Section 533 (as a whole) was "to prevent the development of local media monopolies, and to encourage a diversity of ownership of communications outlets." H.R.Rep. No. 934, 98th Cong., 2d Sess. 55 (1984), *reprinted in* 1984 U.S.C.C.A.N. 4655, 4692. The report further explains that Congress' "intent [in

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[7] Appellees argue that Section 533(b) is not properly termed a cross-ownership bar. Rather, they argue, it is a statute that plainly and simply bans speech. It is clear, however, that, although the wording of Section 533(b) does not explicitly bar cross-ownership, the effect of Section 533(b) is to prevent a common carrier from owning or affiliating with a cable company operating in its common carrier service area. *See infra* Section III; *see also National Cable Television Ass'n v. FCC*, 914 F.2d 285, 286 (D.C. Cir.1990) (referring to Section 533(b) as a "cross-ownership" rule). To the extent that appellees contend that the moniker 'cross-ownership rule' is inappropriate because Section 533(b) prohibits a telephone company from using its existing technology to transmit its own video programming, such argument is merely semantic.

[8] The cable-broadcasting cross-ownership bar, now found at 47 U.S.C. § 533(a)(1), provides:

> It shall be unlawful for any person to be a cable operator if such person, directly or through 1 or more affiliates, owns or controls, the licensee of a television broadcast station and the predicted grade B contour of such station covers any portion of the community served by such operator's cable system.

enacting Section 533(b) was] to codify current FCC rules concerning the provision of video programming over cable systems by common carriers." *Id.* at 56, *reprinted in* 1984 U.S.C.C.A.N. at 4693. The 1984 Cable Act and its legislative history are otherwise silent as to the purpose or goals of Section 533(b).

In 1987 and 1988, the FCC again undertook a review of whether repeal of the telephone-cable cross-ownership bar would be appropriate. Although it specifically found the bar to be constitutional under intermediate scrutiny, *Telephone Company—Cable Television Cross-Ownership Rules, Section 63.54—63.58*, 3 F.C.C. Rcd. 5849 ¶¶ 76-77 (1988) (Further Notice of Inquiry and Notice of Proposed Rulemaking), the FCC tentatively concluded that repeal of the rule in favor of less restrictive alternatives might be appropriate, *see id.* ¶¶ 78-80. In 1992, the Commission again voted in favor of repeal, provided that "appropriate safeguards" were imposed. *Telephone Co.—Cable Television Cross-Ownership Rules, Sections 63.54—63.58*, 7 F.C.C. Rcd 5781 ¶ 135 (1992) (Second Report and Order, Recommendation to Congress and Second Further Notice of Proposed Rulemaking) ("*Video Dialtone Order*"). Similar positions have been reached by other government agencies, including the Justice Department's Antitrust Division. *Telephone Co.—Cable Television Cross-Ownership Rules, Sections 63.54—63.58*, CC Docket No. 87-266, at 44 (1992) (Reply Comments of the U.S. Dep't of Justice). To date, however, despite numerous proposals to that effect, Congress has yet to repeal Section 533(b).

III.

Much of the disagreement in this case arises from one issue: the proper characterization of Section 533(b). Section 533(b) bars telephone companies from directly or, via affiliates controlled by the companies, indirectly distributing "video programming" to customers of its common carrier services. By regulation, the FCC defines

"control" and "affiliate" as follows: "[T]he terms 'control' and 'affiliate' bar any financial or business relationship whatsoever by contract or otherwise, directly or indirectly between the carrier and the customer, except only the carrier-user relationship." 47 C.F.R. § 63.54(c). Further: "Only those ownership interests which amount to 5 percent or more shall be considered a cognizable ownership 'affiliation' for purposes of this section." *Id.* § 63.54(e)(1).

Paragraph (1) of 47 U.S.C. § 533(b) prohibits (as, similarly, does subsection (b) of 47 C.F.R. § 63.54, the FCC rule underlying Section 533(b)) common carriers from

> provid[ing] channels of communication or pole line conduit space, or other rental arrangements, to any entity which is directly or indirectly owned by, operated by, controlled by, or under common control with such common carrier, if such facilities or arrangements are to be used for, or in connection with, the provision of video programming directly to subscribers in the telephone service area of the common carrier.

As a corollary, however, it seems that the telephone company can legally "provide channels of communications or pole line conduit space" to an *un* affiliated cable operator to use in the provision of video programming in the telephone company's common carrier service area. It has thus been held that, consistent with the FCC rule underlying Section 533(b), "a telephone company can offer pole space to a cable operator that is unaffiliated" with it. *Northwestern Ind. Tel. Co. v. FCC*, 824 F.2d 1205, 1209 (D.C.Cir.1987), *cert. denied*, 493 U.S. 1035, 110 S.Ct. 757, 107 L.Ed.2d 773 (1990). It has further been held "that a telephone company may construct, maintain and own channel distribution facilities and use them to transmit television signals for *independent* cable operators without running afoul of the [FCC]'s cross-ownership

rules." *Id.* (footnote omitted) (emphasis in original); *see* 47 C.F.R. § 63.57.[9] Such involvement by a telephone company in the provision of cable television is construed to fall within the "carrier-user" exception contained in 47 C.F.R. § 63.54(c). Of course, in order to function in its "common carrier" capacity and, thereby, to qualify for the "carrier-user" exception, the telephone company may not engage in "unjust or unreasonable discrimination," 47 U.S.C. § 202, including basing its decision as to whether to provide channel distribution facilities to a particular cable operator on the basis of the content of the speech that operator will convey, *see id.* A similar result, of course, obtains under Section 533(b), under which the FCC regulations lie. *National Cable Television Ass'n v. FCC*, 914 F.2d 285, 289 (D.C.Cir.1990).

From the foregoing, we may distill the following essential understanding of Section 533(b). Section 533(b) allows telephone companies to transmit, without any editorial control, the video programming of unaffiliated cable operators.[10] Further, while telephone companies can "cre-

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[9] Section 63.57 provides, in pertinent part:

> Applications by telephone common carriers for authority to construct and/or operate distribution facilities for channel service to cable systems shall include a showing . . . that the independent cable system proposed to be served had available, at its option, and within the limitations of technical feasibility, pole attachment rights (or conduit space, as the case may be) at reasonable charges and without undue restrictions on the uses that may be made of the channel by the operator.

[10] Appellees dispute that Section 533(b) allows for such activity on the part of the telephone companies, arguing that such activity is barred by Section 533(b)(1)'s prohibition against "direct[] or indirect[]" telephone company "provi[sion of] video programming" to common carrier subscribers. As discussed in the text, the language of Section 533(b)(2) seems inconsistent with this position; moreover, the courts and the FCC have taken the opposite view. We need not definitively decide here whether Section 533(b) in fact allows telephone companies to provide cable transport services to unaffiliated cable operators; instead, we assume that

ate" video programming, they cannot transmit directly their own programming to their local subscribers. While appellants correctly note that the telephone companies *may* legally arrange to have their video programming transmitted to this audience by means of unaffiliated cable or broadcast television operators or by purchasing local broadcast television stations,[11] this argument ignores the practical fact that this ability turns on the whim of local broadcasters and cable operators. In short, while telephone companies *may* legally arrange to have their own video programming transmitted to their local audiences, this does not mean that they *can*, in all cases, achieve this goal. Thus, unlike other video programmers, the tele-

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it does and nonetheless conclude that the provision is unconstitutional. This is because, although, from an economic perspective, an interpretation of Section 533(b) which allows for telephone company provision of cable transport services without editorial control is more favorable to the telephone companies, from the perspective of the First Amendment, the distinction is irrelevant. The First Amendment's problem with Section 533(b) is that the provision does not allow the telephone companies to engage in protected speech, that is, the provision, *with editorial control*, of cable television services. Under either interpretation of Section 533(b), the provision retains its impairing effect on protected speech.

[11] Some appellants also suggest, although appellees note that the various appellants' views have been inconsistent, that Section 533(b) would not bar a telephone company from owning and operating a broadcast station in its area of common carrier service. This is not clear from the language of Section 533(b), which prohibits "any common carrier . . . [from] provid[ing] video programming directly to subscribers in its telephone service area, either directly or indirectly through an affiliate owned by, operated by, controlled by, or under common control with the common carrier," without limiting the prohibited means by which video programming can be carried to the use of the common carrier network. This issue is not today before us and is not essential to our inquiry herein; we assume, for purposes of our analysis herein, that the telephone companies can, consistent with Section 533(b), own broadcast television stations within their respective common carrier service areas.

phone companies *cannot guarantee* that their programming will reach this audience. To this extent, then, Section 533(b) regulates the telephone companies' ability to compete in the video programming market, for a telephone company which chooses to create its own video programming cannot, unlike its competitors, ensure, if it chooses, that its programming will reach any particular audience.

We turn to an examination of how Section 533(b)'s function fulfills the goals which it was enacted to serve. The need for regulation of the telephone companies' entry into the cable medium arises from the peculiar technological characteristics of the cable medium.[12] The Supreme Court explained in *Turner:*

> When an individual subscribes to cable, the physical connection between the television set and the cable network gives the cable operator bottleneck, or gatekeeper, control over most (if not all) of the television programming that is channeled into the subscriber's home. Hence, simply by virtue of its ownership of the essential pathway for cable speech, a cable operator can prevent its subscribers from obtaining access to programming it chooses to exclude.

—— U.S. at ——, 114 S.Ct. at 2466. The telephone companies' common carrier networks are the only electronic means of access to American homes and businesses other than existing coaxial cable wiring networks used by cable operators. Recently, the possibility of transmitting cable programming over these common carrier networks has become a reality. Thus, the peculiar positioning of the local telephone companies makes them natural competitors of the cable operators.

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[12] "[T]he unique physical characteristics of cable transmission should [not] be ignored when determining the constitutionality of regulations affecting cable speech." *Turner Broadcasting Sys., Inc.*, —— U.S. at ——, 114 S.Ct. at 2457.

Appellants advance two justifications for Section 533(b): preventing the telephone companies from engaging in monopolistic practices against the cable industry and maintaining diversity in ownership of communications outlets. Although, at first glance, the section appears to inhibit competition and undermine diversity by effectively keeping the telephone companies, the natural technological predators of the cable companies, largely out of the cable business, thereby allowing cable companies to keep their monopolies,[13] the reasoning behind Section 533(b) is that, were telephone companies allowed to compete directly against cable companies, the telephone companies, by virtue of their monopoly position, could and would drive the cable companies out of business, resulting in telephone companies serving as sole "gatekeeper[s]," —— U.S. at ——, 114 S.Ct. at 2466, of the means of electronic access to homes and businesses. *See National Cable Television Ass'n*, 914 F.2d at 287 ("It is clear enough from Congress's explicit adoption of the Commission's ban on cross ownership that the policy of this subsection is to promote competition by curtailing the opportunities telephone companies would otherwise have to take advantage of their monopoly control of the conduits and telephone poles that are required for the transmission of video programs to cable subscribers."). Worse, as explained more fully below, the telephone companies could then use this awesome power to exert monopoly control over the market for video programming products, the so-called video programming market.

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[13] Of course, telephone companies may own cable companies outside of their common carrier service areas, but this does not allow for competition: those telephone company-owned cable companies would presumably still enjoy monopolies since the local telephone company could not use its existing network of wiring to provide, as it easily could, video programming.

IV.

"Video programming" comprises much of the programming provided by cable television companies. It is clear that the provision of cable television service is a form of "speech" protected by the First Amendment.[14] *Turner Broadcasting Sys., Inc.*, —— U.S. at ——, 114 S.Ct. at 2456; *Leathers v. Medlock*, 499 U.S. 439, 111 S.Ct. 1438, 113 L.Ed.2d 494 (1991). Because Section 533(b) impairs the telephone companies' ability to engage in a form of protected speech, we must determine whether Congress' enactment of Section 533(b) violated the First Amendment.

A.

A court, in evaluating whether a regulation of speech runs afoul of the First Amendment, must subject the regulation to a degree of scrutiny determined by the particular circumstances presented. Generally, a regulation that imposes a differential burden on certain speech because of the "content" of that speech alleged to infringe upon protected speech is unconstitutional unless it can survive strict scrutiny. *Turner Broadcasting Sys., Inc.*, —— U.S. at ——, 114 S.Ct. at 2459. By contrast, "regulations that are unrelated to the content of speech are subject to an intermediate level of scrutiny." *Id.* It is under this standard that the government may "impose reasonable restrictions on the time, place, or manner of protected speech" (so-called "time, place and manner restrictions"), provided that the restrictions are content-neutral. *Ward v. Rock Against Racism*, 491 U.S. 781, 789-90, 109 S.Ct. 2746, 2752-53, 105 L.Ed.2d 661 (1989). Last, in rare cases, the Supreme Court has held that the First Amendment requires that certain regulations of speech pass only minimal scrutiny. *See Red Lion Broadcasting*

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[14] The First Amendment provides, in pertinent part, that "Congress shall make no law . . . abridging the freedom of speech." U.S. Const. Amend. I.

Co. v. FCC, 395 U.S. 367, 397-400, 89 S.Ct. 1794, 1810-12, 23 L.Ed.2d 371 (1969).

We consider first the applicability of minimal scrutiny. Concluding that standard to be inapplicable here, we then turn to whether we must apply strict, or merely intermediate, scrutiny.

1.

The government and the NCTA raise several related arguments in favor of the application of minimal scrutiny. None is convincing.

a.

The Supreme Court has generally limited application of minimal scrutiny to First Amendment cases to cases involving regulation of the broadcast media. *See Turner Broadcasting Sys., Inc.*, —— U.S. at ——, 114 S.Ct. at 2456. The Supreme Court has repeatedly emphasized that the reason that regulations of broadcast media need pass only minimal scrutiny is the fact, unique to the broadcast media, that the number of broadcast stations (television and radio) usable productively by society is limited by physical considerations. *See, e.g., id.* at ——-——, 114 S.Ct at 2456-57; *Red Lion Broadcasting Co.*, 395 U.S. at 397-400, 89 S.Ct. at 1810-12.

Appellants suggest that application of minimal scrutiny should extend to regulations governing cable television, arguing that, just as the First Amendment requires only that broadcast television be subjected to limited review because of the physical scarcity of broadcast frequencies, the scarcity of cable systems warrants similar review to regulation of cable television. In short, appellants argue that, although it is undisputed that there is no physical limitation on the number of cable systems that can be constructed or on the number of cable channels that a cable system can support,[15] it is, as a matter

[15] Although the physical capacity of particular, usually older, cable systems may be limited by technological inferiority, nevertheless, the medium as a whole has no practical limits.

of economics, impractical for there to be more than one cable system in any given municipality.

Apart from the question of whether the premise underlying this argument is true, *see Preferred Communications, Inc. v. City of Los Angeles*, 13 F.3d 1327 (9th Cir.) (invalidating, under the First Amendment, a Los Angeles restriction limiting cable service in particular areas of that city to one operator), *cert. denied*, —— U.S. ——, 114 S.Ct. 2738, 129 L.Ed.2d 859 (1994); *Quincy Cable TV, Inc. v. FCC*, 768, F.2d 1434, 1450 (D.C.Cir.1985) ("[T]he tendency toward monopoly, if present at all, may well be attributable more to governmental action—particularly the municipal franchising process—than to any "natural" economic phenomenon."), *cert. denied*, 476 U.S. 1169, 106 S.Ct. 2889, 90 L.Ed.2d 977 (1986), the Supreme Court squarely addressed and rejected this argument in its recent opinion in *Turner Broadcasting System, Inc.*, —— U.S. at ——-——, 114 S.Ct. at 2457-58. We accordingly reject it here.

b.

Appellants' next argument in favor of minimal scrutiny relies upon the Supreme Court's opinion in *FCC v. National Citizens Commission for Broadcasting* ("*NCCB*"), 436 U.S. 775, 98 S.Ct. 2096, 56 L.Ed.2d 697 (1978). At issue in *NCCB* was the constitutionality of a regulation promulgated by the FCC, under which, with few exceptions, a newspaper publisher would be denied a license to operate a broadcasting station in a city in which he, she or it published a newspaper. The Court subjected the regulation to minimal scrutiny and concluded that it was constitutional, finding the FCC's goal of promoting diversity in ownership of mass communications outlets to be in the " 'public interest,' " *id.* at 799, 98 S.Ct. at 2114. Appellants read the Court's opinion to stand for the broad proposition that the First Amendment requires that all regulations which prohibit cross-

ownership of different modes of communications in the same market withstand minimal scrutiny.

Appellants misread the *NCCB*. The Court's reasoning explicitly relied upon the fact that the regulation there at issue affected ownership *of the broadcast media*. *See* 436 U.S. at 799-800, 98 S.Ct. at 2114-15. *NCCB*, then, falls squarely within the *Red Lion* line of cases. Because the instant case does not involve regulation of the broadcast media,[16] *NCCB* is wholly inapposite.

c.

Appellants next argue that, because common carriers have a monopoly benefit conferred upon them, the government has the right to condition continued enjoyment of this benefit upon acceptance of regulation which would ordinarily be deemed violative of the First Amendment. The underpinnings of this *quid pro quo* argument are highly questionable. *See First Nat'l Bank of Boston v. Bellotti*, 435 U.S. 765, 98 S.Ct. 1407, 55 L.Ed.2d 707 (1978) (state cannot limit free speech exercise by corporation chartered under its own laws); *but see id.* at 822-28, 98 S.Ct. at 1439-43 (Rehnquist, J., dissenting) (endorsing the *quid pro quo* theory). However, even were it acceptable to engage in such a *quid pro quo* in certain limited circumstances, there is not a true *quid pro quo* here because the benefit of common carrier status is conferred by state and local governments, yet Section 533(b) is a burden imposed upon the telephone companies by the federal government. As a result, to whatever extent the *quid pro quo* theory outlined above might otherwise have some vitality, it is inapplicable here.

d.

Last, appellants argue that *Associated Press v. United States*, 326 U.S. 1, 65 S.Ct. 1416, 89 L.Ed. 2013

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[16] *See supra* note 11.

(1945), shields Section 533(b) from heightened scrutiny. The issue in *Associated Press* was whether the federal antitrust laws applied to the Associated Press, a news distribution organization then composed of newspaper publishers. Justice Black, writing for the Court, concluded that the generally-applicable antitrust laws were not designed to restrict speech nor, in actual practice, did they. *See id.* at 20 & n. 18, 65 S.Ct. at 1424-25 & n. 18. Consequently, the First Amendment was not implicated. *See id.*[17]

Section 533(b) is not generally applicable; it regulates only local common carriers. Moreover, as discussed above, Section 533(b), by its plain terms, infringes upon protected speech. Appellants' reliance on *Associated Press v. United States* is therefore misplaced.

2.

In light of the foregoing, Section 533(b) must survive some form of heightened scrutiny if it is to be found constitutional. The district court found that the regulation at issue in this case should be subjected to intermediate scrutiny. We agree, although our reasoning differs from that advanced by the district court.

We will subject Section 533(b) to strict scrutiny only if it regulates speech based upon content. "[T]he 'principal inquiry in determining content-neutrality . . . is

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[17] *Associated Press v. United States* is only one in a series of cases standing for the proposition that the press is not immune, by virtue of the First Amendment, from regulations of general applicability imposed by the government. *See Oklahoma Press Publishing Co. v. Walling*, 327 U.S. 186, 192-93, 66 S.Ct. 494, 497-98, 90 L.Ed. 614 (1946) (Fair Labor Standards Act); *Associated Press v. NLRB*, 301 U.S. 103, 132-33, 57 S.Ct. 650, 655-56, 81 L.Ed. 953 (1937) (National Labor Relations Act). *See Turner Broadcasting Sys., Inc.*, —— U.S. at ——, 114 S.Ct. at 2458 ("[T]he enforcement of a generally applicable law may or may not be subject to heightened scrutiny under the First Amendment.").

whether the government has adopted a regulation of speech because of [agreement or] disagreement with the message it conveys.'" *Turner Broadcasting Sys., Inc.*, —— U.S. at ——, 114 S.Ct. at 2459 (quoting *Ward*, 491 U.S. at 791, 109 S.Ct. at 2753-54).[18] *Turner* outlines a two-step inquiry to be undertaken in determining whether a regulation is content-neutral. First, we must examine the plain terms of the regulation to see whether, on its face, the regulation confers benefits or imposes burdens based upon the content of the speech it regulates, *see id.* at ——, 114 S.Ct. at 2459[19]; *id.* at ——, 114 S.Ct. at 2460 (benefits conferred, and burdens imposed, by "must-carry" rules without regard to content). If the regulation's plain language does not, itself, mandate a finding of content discrimination, we then must determine whether, nevertheless there are indications that

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[18] Although a provision that regulates speech that takes a particular position on a given topic is especially offensive to the First Amendment, *see Turner Broadcasting Sys., Inc.*, —— U.S. at ——, 114 S.Ct. at 2481 (Ginsburg, J., concurring in part and dissenting in part), a provision that regulates all speech on a given topic, no matter what position with respect to the topic is advanced, is nevertheless content-based. "The First Amendment's hostility to content-based regulation extends not only to restrictions on particular viewpoints, but also to prohibition of public discussion of an entire topic." *Consolidated Edison Co. of N.Y. v. Public Serv. Comm'n of N.Y.*, 447 U.S. 530, 537, 100 S.Ct. 2326, 2333, 65 L.Ed.2d 319 (1980). Thus, we take the *Turner* Court's reference to the "message" speech conveys to refer not only to the particular side of an issue which certain speech might espouse, but also to any idea or topic upon which the speech might comment, regardless of the position or viewpoint taken.

[19] The *Turner* Court explained:

> As a general rule, laws that by their terms distinguish favored speech from disfavored speech on the basis of the ideas or views expressed are content-based. By contrast, laws that confer benefits or impose burdens on speech without reference to the ideas or views expressed are in most instances content-neutral.

—— U.S. at ——, 114 S.Ct. at 2459 (citations omitted).

the regulation's "manifest purpose is to regulate speech because of the message it conveys." —— U.S. at ——, 114 S.Ct. at 2461. We may discern a statute's manifest purpose from the statute's stated purpose, *id.* at ——, 114 S.Ct. at 2461, or from its "design and operation," *id.*

a.

Section 533(b) regulates telephone company provision of "video programming." Because Section 533(b) prohibits telephone company provision of "video programming" regardless of the message it conveys, the burden it imposes on common carriers is not content-based. Similarly, the benefits afforded by Section 533(b) accrue to all cable system operators, regardless of the content of the speech conveyed by their systems. Thus, Section 533(b) does not, by its terms, regulate speech differently according to the message conveyed thereby.

The district court found that Section 533(b) regulated speech differently according to its content because the determination of whether "video programming" is being provided requires reference to the content of the programming. "Video programming" is defined at 47 U.S.C. § 522(19) as "programming provided by, or generally considered comparable to programming provided by, a television broadcast station." The FCC has interpreted that this definition requires reference to what constituted broadcast television programming in 1984. *Video Dialtone Order, supra*, 7 F.C.C. Rcd. 5781 ¶ 74. On this basis, the district court concluded:

> A moment's reflection makes it readily apparent that the cognitive process necessary to apply the video programming definition cannot be accomplished without comparing the content of the image being tested with the content of 1984 broadcast television programming. . . . [T]here is simply no way that § 533(b) incorporating as it does the § 522(19)

> definition, can be applied without reference to the content of the message being conveyed.

830 F.Supp. at 923 (footnote omitted).

We disagree. While a content-based distinction necessarily involves consideration of the nature of the message sought to be conveyed, the converse is not true in all cases, *i.e.*, that a regulation requires some examination of the speech upon which it has impact does not make the regulation content-based. In particular, the government may validly examine the mode of delivery of speech to determine whether it is delivered in conformity with a "manner" restriction, provided that the restriction does not discriminate based upon the content of speech.

Instructive with regard to when the reference a regulation makes to speech is so unintrusive that the regulation is not thereby rendered content-based is *Regan v. Time, Inc.*, 468 U.S. 641, 104 S.Ct. 3262, 82 L.Ed.2d 487 (1984), where the Court upheld the validity of a statute regulating the size and color of permissible copying of United States currency. Justice White wrote for a four-member plurality [20]:

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[20] Chief Justice Burger and Justices Rehnquist and O'Connor joined this portion of Justice White's opinion. Justice Stevens concurred in this portion of the plurality's judgment, 468 U.S. at 700-04, 104 S.Ct. at 3294-96. Justice Brennan, joined in dissent by Justice Marshall, disagreed with the conclusion reached by the plurality with respect to the size and color restrictions at issue, although they declined to address the question of whether any size and color restriction could be constitutional, *see id.* at 688 n. 27, 104 S.Ct. at 3288-89 n. 27. Justice Powell, joined in partial concurrence and partial dissent by Justice Blackmun, would have invalidated completely, on other grounds, the statute containing the size and color restrictions and therefore found it unnecessary to reach the question of whether the size and color restrictions at issue were constitutional, although the opinion makes reference to the "strong policy arguments in favor of upholding the color and size restrictions" identified by Justice Stevens in his opinion, *see id.* at 692, 104 S.Ct. at 3290.

> [T]he size and color limitations do not discriminate on the basis of content. Compliance with the color and size requirements does not prevent Time from expressing any view on any subject or from using illustrations of currency in expressing those views. More importantly, *the Government does not need to evaluate the nature of the message being imparted in order to enforce the color and size limitations. Those limitations restrict only the manner in which the illustrations can be presented.*

468 U.S. at 655-56, 104 S.Ct. at 3270-71 (emphasis added). Analogizing them to valid restrictions on noise level that can be placed on announcements in residential areas and size and height limitations that can be placed on outdoor signs, the opinion upheld the color and size restrictions.[21] *Id.* at 656, 104 S.Ct. at 3271; *see id.* at 704, 104 S.Ct. at 3296 (Stevens, J., concurring in part and dissenting in part) ("Time is free to publish the symbol it wishes to publish and to express the messages it wishes to convey by use of that symbol; it merely must comply with restrictions on the manner of printing that symbol which are reasonably related to the strong governmental interests in preventing counterfeiting and deceptive uses of likenesses of currency."). Examination of Section 533(b) in light of *Regan* establishes that the regulation here at issue is not content-based. Section 533(b) does not regulate speech differently based upon the content of the speech; rather, it distinguishes speech solely on the basis of whether the speech takes the form of "video programming," *i.e.*, on the basis of the mode of delivery of the speech. In short, Section 533(b) is not content-based because, in determining whether "video programming" is being transmitted, "the Government does

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[21] By contrast, the same Court, with only Justice Stevens dissenting, found that a provision of the statute which turned permissibility of a reproduction of currency upon the purpose of the reproduction was content-based, *see* 468 U.S. at 648-49, 104 S.Ct. at 3266-67.

not need to evaluate the nature of the message being imparted."[22] *Regan*, 468 U.S. at 656, 104 S.Ct. at 3271; *see Turner Broadcasting Sys., Inc.*, —— U.S. at ——, 114 S.Ct. at 2460 (finding that the "must-carry" rules are not content-based because they "distinguish between speakers in the television programming market . . . based

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[22] Focusing on a single passage from *Turner Broadcasting System, Inc.* where the Court found that "Congress' overriding objective in enacting must-carry was not to favor programming of a particular subject-matter, viewpoint, or format, but rather to preserve access to free television programming for the 40 percent of Americans without cable," —— U.S. at ——, 114 S.Ct. at 2461, appellees argue that the Court's use of the word "format" in the foregoing quote indicates that any statute which regulates speech based upon its "format" is content-based and that whether particular speech constitutes "video programming" is a question of "format." We disagree. While the question of whether programming is "video programming" surely goes to the programming's "format," in its most general usage, *see The American Heritage Dictionary* 526 (2d ed.) (defining "format" as "[a] plan for the organization and arrangement of a specified production"), so, too, would the size and color restrictions as to permissible copying of United States currency considered in *Regan, supra*. "Format" does not, in every usage, have bearing on "content," however. *See, e.g., Arkansas Writers' Project, Inc. v. Ragland*, 481 U.S. 221, 232-33, 107 S.Ct. 1722, 1729, 95 L.Ed.2d 209 (1987) ("Appellant contends that, under applicable state regulations, . . . the critical distinction between newspapers and magazines is *not format*, but *rather content* . . . ." (emphasis added)). We believe, contrary to appellees' position, that the Court in *Turner* intended its use of the word "format" to convey the notion that laws which regulate particular "formats" of speech which are likely to convey particular viewpoints or to engage discussion with respect to particular topics, *i.e., e.g.*, documentaries, news programs, sitcoms, are content-based.

We note, finally, that the FCC interpretation of the statutory language may vest too much discretion in that agency in determining what a telephone company may transmit directly to its local customers. *See Forsyth County v. Nationalist Movement*, —— U.S. ——, ——-——, 112 S.Ct. 2395, 2401-02, 120 L.Ed.2d 101 (1992); *City of Lakewood v. Plain Dealer Publishing Co.*, 486 U.S. 750, 769-70, 108 S.Ct. 2138, 100 L.Ed.2d 771 (1988). This, however, is a problem distinct from whether Section 533(b) is content-based, and is not raised here.

only upon the *manner* in which speakers transmit their messages, and not upon the messages they carry" (emphasis added))[23]; *cf. City of Cincinnati v. Discovery Network, Inc.*, —— U.S. ——, ——, 113 S.Ct. 1505, 1516, 123 L.Ed.2d 99 (1993) ("sweeping ban on use of newsracks that distribute 'commercial handbills,' but not 'newspapers' " is content-based).

Additionally, while Section 533(b) imposes burdens on speech according to the identity of the speaker, the Court in *Turner* specifically rejected "the broad assertion that all speaker-partial laws are presumed invalid," —— U.S. at ——, 114 S.Ct. at 2467,[24] explaining instead that "speaker-based laws demand strict scrutiny when they reflect the Government's preference for the substance of what the favored speakers have to say (or aversion to what the disfavored speakers have to say)." *Id.* In other words, "laws favoring some speakers over others demand strict scrutiny when the legislature's speaker preference reflects a content preference." *Id.*

We determine whether a speech regulation partial to certain speakers is content-based mindful of the "physical characteristics" and "economic incentives" inherent to the particular type of speech regulated. *Turner Broadcasting*

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[23] We also note that Court in *Turner* rejected the argument, advanced by the dissent in the three-judge district court below, that, because the class of broadcasters to be benefitted by the "must-carry" rules, *i.e.*, local broadcasters, are subject to FCC content-based regulation, the "defin[ition] of the benefitted class *automatically* entails content requirements." *Turner Broadcasting Sys., Inc. v. FCC*, 819 F.Supp. 32, 58 (D.D.C.1993) (Williams, J., dissenting). The Court found this argument to "exaggerate[] the extent to which the FCC is permitted to intrude into matters affecting the content of broadcast programming." —— U.S. at ——, 114 S.Ct. at 2463.

[24] To the extent that our decision in *Henrico Professional Firefighters Ass'n, Local 1568 v. Board of Supervisors of Henrico County*, 649 F.2d 237 (4th Cir.1981), is to the contrary, it is no longer good law. *See also infra* note 28.

Sys., Inc., —— U.S. at ——, 114 S.Ct. at 2467. Here, as described above, the FCC and Congress have regulated the telephone companies' provision of cable service in light of the physical "bottleneck," *id.* at ——, 114 S.Ct. at 2466, peculiar to cable communications, *see id.*, and the perception that the telephone companies, absent regulation, would have the incentive and ability to dominate that bottleneck and establish themselves as sole "gatekeeper[s]", *id.*, thereof. Because Section 533(b)'s speaker distinction is thus justifiable entirely on the basis of the peculiar economic and physical venue inherent to cable communications, we conclude that it is not an improper content-based distinction.[26]

b.

That section 533(b) does not, on its face, "burden or benefit speech of a particular content does not end the inquiry," —— U.S. at ——, 114 S.Ct. at 2461; "a regulation neutral on its face may be content-based if its manifest purpose is to regulate speech because of the message it conveys," *id.*

A review of Section 533(b)'s history, including the origins of the precursor FCC rule, discloses no illicit government motive; it instead confirms that the "manifest purpose" of the provision is to inhibit the telephone companies' exercise of monopolistic practices in the cable transport market and to preserve diversity of ownership of electronic means of access to homes and businesses, not to bar the telephone companies from transmitting programming of a particular content. It is true that Congress' decision to replace, in drafting Section 533(b) based upon the FCC rule, "CATV" with the phrase "video programming" is unexplained. However, in light of the discussion above, we discern no illicit content-discriminatory motive in this decision.

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[26] We address below the concerns raised by the small size of the class of speakers burdened by Section 533(b).

Our content-neutrality analysis is still not at an end, as we have yet to examine Section 533(b)'s "design and operation," —— U.S. at ——, 114 S.Ct. at 2461. The *Turner* Court, *id.* at ——, 114 S.Ct. at 2462, identified certain "signs" that a content-based regulation will likely exhibit: such a regulation may confer benefits based upon content of speech, "require or prohibit the [expression] of certain ideas or points of view," *id.*, penalize speakers because of speech content, compel speakers to affirm points of view with which they disagree, or "produce any net decrease in the amount of available speech," *id.* All but one of these "signs" are clearly absent here. Section 533(b) does not benefit or burden speech based upon content, it does not require the telephone companies to express points of view with which they disagree or, for that matter, any point of view, and it does not prohibit telephone company expression of any point of view or on any subject.

The question of whether Section 533(b) "produce[s a] net decrease in the amount of available speech" requires closer attention. A regulation that, in fact, decreases the amount of available speech may operate as a content-based regulation because, by limiting the amount of available speech, the likelihood that some point of view or discussion on a particular topic may not occur is enhanced. Along these lines, the *Turner* Court reaffirmed that "[r]egulations that discriminate among media, or among different speakers within a single medium, often present serious First Amendment concerns." *Id.* at ——, 114 S.Ct. at 2468. The Court proceeded to clarify that the First Amendment does not mandate strict scrutiny "for any speech regulation that applies to one medium (or a subset thereof) but not others." *Id.*

> Rather, laws of this nature are "constitutionally suspect only in certain circumstances." [*Leathers*, 499 U.S.], at 444 [111 S.Ct. at 1442]. The taxes invalidated in [*Minneapolis Star and Tribune Co.* v.

> *Minnesota Commissioner of Revenue*, 460 U.S. 575, 581, 103 S.Ct. 1365, 1369-70, 75 L.Ed.2d 295 (1983),] and [*Arkansas Writers' Project, Inc. v. Ragland*, 481 U.S. 221, 231, 107 S.Ct. 1722, 1728-29, 95 L.Ed.2d 209 (1987)], for example, targeted a small number of speakers, and thus threatened to "distort the market for ideas." 499 U.S., at 448 [111 S.Ct. at 1444]. Although there was no evidence that an illicit governmental motive was behind either of the taxes, both were structured in a manner that raised suspicions that their objective was, in fact, the suppression of certain ideas. See *Arkansas Writers' Project, supra*, 481 U.S., at 228-229 [107 S.Ct. at 1727-28]; *Minneapolis Star*, 460 U.S., at 585 [103 S.Ct. at 1371-72]. But such heightened scrutiny is unwarranted when the differential treatment is "justified by some special characteristic of" the particular medium being regulated. *Ibid.*

Id. Although common carriers are not members of "the press" insofar as 47 U.S.C. § 202 precludes them from exercising editorial control over the communications they transmit, the foregoing would nevertheless seem applicable to Section 533(b), which restricts a class of speakers from joining the press by operating, with editorial control and within certain areas, cable systems. Moreover, we see no reason why a government regulation which discriminates against a particular class of speakers behind which "there [is] no evidence [of] an illicit governmental motive," *id.*, but which is "structured in a manner that raise[s] suspicions that [its] objective was, in fact, the suppression of certain ideas," *id.*, would not similarly be subject to strict scrutiny.

Here, because Section 533(b) affects, in any one given geographic area, only the local common carrier, Section 533(b) might be said to be "structured in a manner that raise[s] suspicions that [its] objective was, in fact, the suppression of certain ideas." *Turner Broadcasting Sys., Inc.*, —— U.S. at ——, 114 S.Ct. at 2468; *cf. Arkansas*

Writers' Project, Inc., 481 U.S. at 228, 107 S.Ct. at 1727 ("[S]elective taxation of the press—either singling out the press as a whole or targeting individual members of the press—poses a particular danger of abuse by the State."); *Minneapolis Star and Tribune Co.*, 460 U.S. at 592, 103 S.Ct. at 1375 ("[W]hen [a tax] exemption [for which only certain members of the press qualify] selects . . . a narrowly defined group to bear the burden of the tax, the tax begins to resemble more a penalty for a few of the largest newspapers than an attempt to favor struggling smaller enterprises."). Once again, however, the peculiar nature of cable service convinces us otherwise. As discussed above, Section 533(b)'s discrimination against telephone companies as speakers is justified entirely by the peculiar economic and physical characteristics inherent in the provision of cable service. Because, then, "the differential treatment [of speakers] is 'justified by some special characteristic of' the particular medium being regulated," —— U.S. at ——, 114 S.Ct. at 2468 (quoting *Minneapolis Star and Tribune Co.*, 460 U.S. at 585, 103 S.Ct. at 1372), application of strict scrutiny is not warranted.

The fact that the class of speakers affected adversely by Section 533(b) happens to be particularly small does not, in our opinion, change this result. It is true that the Court in *Turner* reached the conclusion that the speaker distinction imposed by the "must-carry" rules there at issue did not warrant strict scrutiny both because the speaker distinction was justified by the peculiar characteristics of the cable medium, *see* —— U.S. at ——, 114 S.Ct. at 2468, and because the rules apply "to almost all cable systems in the country, rather than just a select few," *id.* We believe, however, that *Turner*, *Arkansas Writers' Project*, *Minneapolis Star*, and *Leathers* establish that concerns as to the size of the class of speakers adversely affected by a speech regulation arise only where membership in the class is not justified by the characteristics of the particular medium being subjected to regula-

tion.[26] The *Turner* Court exception to the presumption that a narrow speaker distinction is constitutionally suspect confirms our belief, for it makes no mention of the size of the speaker class adversely affected by the regulation: "[S]uch heightened scrutiny is unwarranted when the differential treatment [accorded different speakers] is 'justified by some special characteristic of' the particular medium being regulated." —— U.S. at ——, 114 S.Ct. at 2468 (quoting *Minneapolis Star and Tribune Co.*, 460 U.S. at 585, 103 S.Ct. at 1372). Thus, while a government regulation that "target[s] a small number of speakers [may] threaten[ ] to 'distort the market for ideas,'" *Turner Broadcasting Sys., Inc.*, —— U.S. at ——, 114 S.Ct. at 2468 (quoting *Leathers*, 499 U.S. at 448, 111 S.Ct. at 1444), we do not think that a regulation can be said to "target" a group of speakers where the membership in the group is determined solely by the peculiar characteristics of the medium of speech being regulated.

Section 533(b) cannot be said to "target" a small class of speakers; rather, Congress enacted Section 533(b) so as to preserve diversity of ownership of the "bottleneck" of the means of electronic access into homes and businesses. That Congress has determined that this goal is achieved by regulating what turns out, incidentally, to be a small class of speakers does not evince congressional intent to "target" those speakers. *See Ward*, 491 U.S. at 791, 109 S.Ct. at 2754 ("A regulation that serves purposes unrelated to the content of expression is deemed neutral, even if it has an incidental effect on some speakers . . . but not others."). In short, while it is true that, because of the small class of speakers it adversely affects,

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[26] The Court in *Arkansas Writers' Project* and *Minneapolis Star* held the discriminatory taxes there at issue unconstitutional because, *inter alia*, the taxes' speaker distinction, not surprisingly, was not justified by the particular characteristics of the medium being taxed; neither case holds that *any* speech regulation which regulates a small group of speakers differentially will be treated as constitutionally suspect.

Section 533(b) bears some "resembl[ance to] a penalty for particular speakers or particular ideas," *Leathers*, 499 U.S. at 449, 111 S.Ct. at 1445, this apparent resemblance is dispelled by the logical, content-neutral explanation for Section 533(b)'s regulation of this class.

Appellees further argue that the fact that Section 533(b) so severely limits the speech of such a small class of speakers requires application of strict scrutiny. We disagree. As just established, because the identity and size of the speaker class here adversely affected result solely from the peculiar characteristics of the cable medium, such considerations are not relevant to the content-neutrality inquiry. Putting the size of the class of regulated speakers aside, then, while Section 533(b)'s limitations on telephone companies' speech may aptly be described as "severe," at least in some sense of the word, we cannot say that the limitations imposed are "likely to stifle the free exchange of ideas." *Leathers*, 499 U.S. at 453, 111 S.Ct. at 1447. Section 533(b)'s operation is in no way content-based. Consequently, the telephone companies are free to engage in speech advancing any view with respect to any topic. Indeed, they may even transmit, with full editorial control, programming, other than "video programming" over their own common carrier networks.[27] For these reasons, we reject appellees' argument in this regard.[28] *See Frisby v. Schultz*, 487

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[27] We do not mean to imply that such "non-video programming" will be as effective a communicative tool as "video programming." Such a concern, however, does not enter into the content neutrality analysis we currently undertake; it is properly addressed, and we address it, in our consideration of whether Section 533(b) affords viable alternative means of communication in the context of the application of intermediate scrutiny.

[28] To the extent that our decision in *Henrico Professional Firefighters Ass'n, Local 1568 v. Board of Supervisors of Henrico County*, 649 F.2d 237 (4th Cir.1981), is to the contrary, it has been eclipsed by *Leathers* and *Turner* and is no longer good law. *See also supra* note 24.

U.S. 474, 108 S.Ct. 2495, 101 L.Ed.2d 420 (1988) (subjecting regulation which prohibited picketing "before or about" any residence to intermediate scrutiny); *cf. Lovell v. City of Griffin*, 303 U.S. 444, 451, 58 S.Ct. 666, 669, 82 L.Ed. 949 (1938) (ordinance which "comprehensive[ly]" banned distribution of pamphlets regardless of method was "invalid on its face").

Accordingly, we will subject Section 533(b) to intermediate scrutiny and see if it passes muster.

B.

To pass intermediate scrutiny, a content-neutral speech regulation must be " 'narrowly tailored to serve a significant governmental interest, and . . . leave open ample alternative channels for communication of the information.' " *Ward*, 491 U.S. at 791, 109 S.Ct. at 2753 (quoting *Clark v. Community for Creative Non-Violence*, 468 U.S. 288, 293, 104 S.Ct. 3065, 3069, 82 L.Ed.2d 221 (1984)). For ease of discussion, we isolate the following prongs which must be satisfied for constitutionality to be concluded: (1) the interests which Section 533(b) purports to serve must be "significant"; (2) Section 533 (b) must be "narrowly tailored" to serve those interests; and (3) Section 533(b) must "leave open ample alternative channels for communication of the information" the transmission of which Section 533(b) regulates. We examine each of these prongs *seriatim*.

1.

As discussed above in Section III, dual goals underlie Section 533(b): restricting telephone company exercise of cross-subsidization and pole-access discrimination (perhaps, now that technology allows the telephone companies to transmit video programming directly over their common carrier lines, more aptly described as network-access discrimination) in the cable medium, and preserving diversity of ownership of communications outlets and of the

means of electronic access to homes and businesses. To determine whether these interests are "significant," we need not look beyond the Supreme Court's opinion in *Turner*. First, with respect to the restraint of unfair trade practices on the part of the telephone companies, Justice Kennedy explained, "[T]he government's interest in eliminating restraints on fair competition is always substantial, even where the individuals or entities subject to particular regulations are engaged in expressive activity protected by the First Amendment." —— U.S. at ——, 114 S.Ct. at 2470. Second, with respect to diversity of ownership of communications outlets, Justice Kennedy explained: "[A]ssuring that the public has access to a multiplicity of information sources is a governmental purpose of the highest order, for it promotes values central to the First Amendment." *Id.* Also of great significance is the government's interest in "ensur[ing] that private interests not restrict, through physical control of [the] critical ['bottleneck'] of [cable] communication, the free flow of information and ideas," *id.* at ——, 114 S.Ct. at 2466. *See id.*

There can be no question, then, but that the interests Section 533(b) serves are "significant."

2.

For a remedy to be considered narrowly tailored, it "need not be the least-restrictive or least-intrusive means" of achieving the government's goal. *Ward*, 491 U.S. at 798, 109 S.Ct. at 2757. "Rather, the requirement of narrow tailoring is satisfied 'so long as the . . . regulation promotes a substantial government interest that would be achieved less effectively absent the regulation.'" *Id.* at 799, 109 S.Ct. at 2758 (footnote omitted) (quoting *United States v. Albertini*, 472 U.S. 675, 689, 105 S.Ct. 2897, 2906, 86 L.Ed.2d 536 (1985)). However, a regulation that "burden[s] substantially more speech than is necessary to further the government's legitimate interests" is not narrowly tailored. *Id.*

In determining whether a statute is narrowly tailored, we generally "afford great weight to the decisions of Congress and the experience of the [FCC]." *Columbia Broadcasting Sys., Inc. v. Democratic Nat'l Comm.*, 412 U.S. 94, 102, 93 S.Ct. 2080, 2086, 36 L.Ed.2d 772 (1973). This deference is not without its bounds, however. In the context of intermediate scrutiny, we owe deference to the Congress only to the extent that it makes factual findings regarding the need for the particular measure enacted; "if there are numerous and obvious less-burdensome alternatives to the restriction," *City of Cincinnati v. Discovery Network, Inc.*, —— U.S. at —— & n. 13, 113 S.Ct. at 1510 & n. 13, we will not accede to Congress' judgment, *see id.* [20] ; *Sable Communications*

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[20] In *City of Cincinnati*, the Court was faced with a city ordinance which prohibited the placement on public property of newsracks used to distribute commercial publications. The city urged that the regulation at issue reasonably "fit" the city's "substantial" goals of safety and esthetics, as required for a regulation of commercial speech to be constitutional, *see Board of Trustees of the State Univ. of N.Y. v. Fox*, 492 U.S. 469, 480, 109 S.Ct. 3028, 3034-35, 106 L.Ed.2d 388 (1989). The Court rejected this argument, noting, in pertinent part, that "the city['s] fail[ure] to address its recently developed concern about newsracks by regulating their size, shape, appearance, or number indicates that it has not 'carefully calculated' the costs and benefits associated with the burden of speech imposed by its prohibition." *City of Cincinnati*, —— U.S. at ——, 113 S.Ct. at 1510. Explained the Court:

> We reject the city's argument that the lower courts' and our consideration of alternative, less drastic measures by which the city could effectuate its interests in safety and esthetics somehow violates *Fox*'s holding that regulations on commercial speech are not subject to "least-restrictive-means" analysis. . . . A regulation need not be "absolutely the least severe that will achieve the desired end," *Fox, supra*, 492 U.S. at 480, 109 S.Ct. at 3035, but if there are numerous and obvious less-burdensome alternatives to the restriction on commercial speech, that is certainly a relevant consideration in determining whether the "fit" between ends and means is reasonable.

Id. at —— n. 13, 113 S.Ct. at 1510 n. 13. Because commercial speech receives less First Amendment protection than does non-

of Cal., Inc. v. FCC, 492 U.S. 115, 129, 109 S.Ct. 2829, 2838, 106 L.Ed.2d 93 (1989) (declining, in determining whether statute banning indecent interstate commercial telephone communications was narrowly-tailored, to accord deference to Congress where "the congressional record contains no legislative findings that would justify us in concluding that there is no constitutionally acceptable less restrictive means, short of a total ban, to achieve the Government's interest in protecting minors"). *See also Turner Broadcasting Sys., Inc.*, —— U.S. at ——, 114 S.Ct. at 2471 (plurality opinion) ("Congress is not obligated, when enacting its statutes, to make a record of the type that an administrative agency or court does to accommodate judicial review." Nonetheless, courts retain an "obligation to exercise independent judgment when First Amendment rights are implicated . . . to assure that, in formulating its judgment, Congress has drawn reasonable inferences based upon substantial evidence.").

In order to determine whether Section 533(b) is "narrowly tailored" to serve the government's significant interests, it is necessary first to understand precisely how Section 533(b) has been tailored, *i.e.*, exactly how Section 533(b) purports to fulfill the goals to which it is dedicated. The theory behind Section 533(b) is far from apparent. As described above, it was feared that the telephone companies, as monopolists, would engage in the anti-competitive practices of cross-subsidization and pole-access discrimination, thereby threatening the maintenance of diversity of ownership of the means of communication, that prompted the FCC to enact the regulatory precursor to Section 533(b). With respect to pole-access discrimination, as the district court aply noted,

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commercial speech, *see Fox*, 492 U.S. at 478, 109 S.Ct. at 3033-34, and in light of the fact that intermediate scrutiny also does not impose a "least-restrictive-means" analysis, *Ward*, 491 U.S. at 798, 109 S.Ct. at 2757, the foregoing clearly applies to determinations of narrow tailoring under intermediate scrutiny.

> to the extent that the existing Pole Attachment Act does not entirely prevent the possibility of pole access discrimination, effective legislation could be passed to guarantee non-discriminatory access. If discriminatory pole access were the sole concern of Congress in enacting a prophylactic ban on a telephone company's ability to speak through video programming, then such a ban would plainly burden more speech than necessary to further the government's interests.

830 F.Supp. at 930 n. 29. We focus, then, on Section 533(b)'s effect on cross-subsidization.

A telephone company will engage in cross-subsidization only if it has both the ability and the incentive to do so. Section 533(b) allows a telephone company, or an affiliate thereof to contract to transmit an unaffiliated entity's cable services over the telephone company's network. Thus, a telephone company may, consistent with Section 533(b), lease to an unaffiliated cable operator "space" on its common carrier network to transmit video programming. Section 533(b) does not, then, prohibit the telephone companies from cross-subsidizing their entry into the cable transport leasing market; indeed, the appellants do not argue otherwise.[30]

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[30] Appellant NCTA argues:

> If a telephone company can offer only transmission services, the telephone company cannot translate any artificially low prices directly into low prices for cable consumers. The retailer offering the programming directly to consumers sets the retail price and, while paying improperly low prices for transmission, can choose to pocket the transmission savings without lowering retail prices (much or at all).

Appellant NCTA's Br. 42. We are not impressed with the strength of this argument. First, pursuant to 47 C.F.R. § 63.54(e), the mere fact that a telephone company may possess up to a 5 percent ownership interest in a cable operator does not mean that the telephone company and cable operator are "affiliat[ed]." Thus, a telephone company may legally accumulate a holding in the local

At best, then, Section 533(b) achieves its goal of eliminating telephone company cross-subsidization by removing the telephone companies' incentive to engage in that practice. The government suggests that the goal which the telephone companies expect to result from the cross-subsidization which they undertake is domination of the video programming market. In particular, the government suggests that cross-subsidization will secure for the telephone companies domination over the cable transport market and domination over the electronic means of access to American homes and businesses; this positioning, in turn, would force video programmers wishing to have their programming transmitted over cable television to do business with the telephone companies. In short,

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cable company with which the telephone company has contracted to provide cable transport service sizable enough to argue persuasively that it is advantageous for the cable operator not to "pocket the transmission savings without lowering retail prices," but instead to pass savings along to its customers to drive its cable competitors out of business. Second, and moreover, the evil of cross-subsidization manifests itself in any way that the telephone company can use its common carrier monopoly power to establish dominance in the cable transport market. In the instant context, even if the cable operator with which the telephone company has contracted chooses not to pass the savings it garners as a result of its improperly low transmission costs, the cable operator may instead put those savings toward the purchase of more popular, or simply more, video programming, in an effort to distinguish itself from its competitors. Whether the cable operator opts to "pocket" these savings or not, then, telephone company cross-subsidization will allow that cable operator, and hence the telephone company, to establish dominance over the cable transport market, whereupon the telephone company could likely extract some portion of the unaffiliated cable operator's monopoly profits by virtue of the telephone company's monopoly over the means of transmission. Last, we would observe that one of the downsides of cross-subsidization is the misallocation of telephone company resources and the higher rates common carrier subscribers are obligated to pay as results of cross-subsidization; these evils occur regardless of whether the telephone companies and the cable companies with which they contract seek to use cross-subsidization to dominate the cable transport market.

say appellants, it is the promise of the green pastures of domination over the video programming market that provides an incentive, indeed an "irresistible" incentive, *C & P*, 830 F.Supp. at 927, to establish control over the cable transport market. Absent this irresistible incentive, although the telephone companies could still establish domination over the video transport market, they will not act to do so.

At this juncture, we assume, *arguendo*, (1) that ordinary regulatory oversight is insufficient to guard against telephone company use of cross-subsidization in the cable transport market; and (2) that the proffered explanation of how the possibility of domination over the video programming market provides an "irresistible" incentive to the telephone companies to engage in unfair competition in the cable transport market, without which they would not so act. We therefore assume that the possibility that a telephone company may engage in cross-subsidization in the cable transport market presents a problem [31] which may properly demand congressional or regulatory attention, and that the problem may properly be addressed by regulation of the video programming market. One problem with Section 533(b) remains: we are not convinced that Section 533(b)'s remedy is narrowly tailored to serve the goal of ameliorating this problem.

The Congress did not buttress Section 533(b) with any underlying factual findings. Even the legislative history, to the extent that is relevant in this regard, *compare Sable Communications of Cal., Inc.*, 492 U.S. at 133, 109 S.Ct. at 2840 (Scalia, J., concurring) ("Neither due process nor the First Amendment requires legislation to

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[31] We nevertheless echo the district court's observation that, "[e]ven under the government's worst case scenario, in which the telephone companies succeed in driving out all competition for the provision of video transport service, the telephone companies would be in no better position to act anti-competitively in the video programming market than are the current monopolists in the video transport market, the existing cable operators." 830 F.Supp. at 930.

be supported by committee reports, floor debates, or even consideration, but only by a vote."), offers only a broad statement about preserving diversity of ownership of communications outlets.[32] While the FCC's development of the rule that preceded Section 533(b) is more fully documented, and while we may presume that Congress relied, at least to some degree, thereon, we note that the FCC's reasoning does not indicate that attention was devoted to the possibility of other, less drastic regulatory schemes that might achieve the substantial government interests enunciated above.[33] Further, perhaps be-

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[32] Appellants note that Congress has considered and rejected the possibility of repealing Section 533(b) several times since its enactment. They point to various statements of legislators during these debates indicating a belief that no less restrictive alternative to Section 533(b) would effectively serve the provision's goals. We note, preliminarily, that these statements do not undertake to explain the complex relationship between Section 533(b) and these goals. Moreover, however, we cannot accept as authoritative with regard to a provision enacted by a previous Congress statements by single legislators made during debate of a bill, which was never enacted as law, only one consequence of which would have been the repeal of the provision at issue. "[F]ailed legislative proposals are 'a particularly dangerous ground on which to rest an interpretation of a prior statute,'" *Central Bank of Denver, N. A. v. First Interstate Bank of Denver, N. A.*, —— U.S. ——, ——, 114 S.Ct. 1439, 1453, 128 L.Ed.2d 119 (1994) (quoting *Pension Benefit Guar. Corp. v. LTV Corp.*, 496 U.S. 633, 650, 110 S.Ct. 2668, 2678, 110 L.Ed.2d 579 (1990)), let alone for determining whether the earlier Congress considered and rejected less restrictive alternatives to that statute.

[33] We would speculate that the FCC at the time it enacted the regulatory precursor to Section 533(b), and, subsequently, the Congress in reliance thereon, may have believed, although erroneously, that a statute banning the telephone companies from the cable television market was constitutional on the same theroy as the broadcast television-newspaper cross-ownership ban upheld in *NCCB* and that, therefore, it was unnecessary to devote much attention to the possibility of less restrictive means of achieving the goals desired.

We also note that the Fifth Circuit, in approving the FCC rule that fostered Section 533(b), understood that rule to "bar the

cause the FCC's motivation for enacting the regulatory precursor to Section 533(b) was the threat to the cable transport market that telephone company engagement in pole-access discrimination and cross-subsidization posed, the FCC's contemporaneous discussions of its rule do not even hint at the complex of incentives and evils, outlined above, involving the cable transport and video programming markets.

Moreover, we agree with the district court, 830 F. Supp. at 930-31, that an "obvious less-burdensome alternative[]" to Section 533(b) readily presents itself (and indeed has been identified by the FCC as a possible alternative to Section 533(b) in its recommendation to Congress to repeal the provision): Congress could simply limit the telephone companies' editorial control over video programming to a fixed percentage of the channels available; the telephone companies would be required to lease the balance of the channels on a common carrier basis to various video programmers, without regard to content. *See Video Dialtone Order, supra,* 7 F.C.C. Rcd. 5781 ¶¶ 141-143.[34]

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telephone companies and their affiliates from engaging in CATV operations in the carriers' service areas." *General Tel. Co. of the Southwest v. United States,* 449 F.2d 846, 859 (5th Cir.1971). To the extent that this understanding was accurate, because the FCC rule truly banned telephone company entry into cable television and therefore in particular, the cable transport market, there was no need to understand or make reference to the series of evils outlined in the text. We observe that the Fifth Circuit did not address the question of whether the FCC rule passed muster under the First Amendment and, therefore, did not address the question of whether its desired effect could have been achieved by some alternative less restrictive of protected speech.

[34] We need not address, and do not purport to address, the constitutionality of this alternative to Section 533(b). We cite the alternative not to imply *its* constitutionality, but only to show that Section 533(b) is itself unconstitutional.

At bottom, we conclude that Section 533(b) is not narrowly tailored because the government has failed to demonstrate why Section 533(b) does not, by removing the "irresistible" incentive which domination of that market provides, "burden substantially more speech than is necessary," *Ward*, 491 U.S. at 799, 109 S.Ct. at 2758.[35] *See Turner Broadcasting Sys., Inc.*, —— U.S. at ——, 114 S.Ct. at 2470 (plurality opinion) ("When the Government defends a regulation on speech as a means to . . . prevent anticipated harms, it must do more than simply 'posit the existence of the disease sought to be cured.' . . . It must demonstrate that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way." (quoting *Quincy Cable TV, Inc.*, 768 F.2d at 1455)).

C.

Having concluded that Section 533(b) is not "narrowly tailored" to serve the goals to which it is dedicated, we must find that the provision has not been able to withstand intermediate scrutiny. That Section 533(b) is not "narrowly tailored" is not its only infirmity to intermediate scrutiny, however; the provision also does not leave the telephone companies with ample alternative channels for communication.[36]

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[35] As noted above, the telephone compa[illegible] have no inherent technological advantage that would allow them to compete unfairly in the video programming market. Nonetheless, if domination of that market provides such an incentive to the telephone companies to overtake the cable transport market, then some additional monitoring of the video programming market, such as the regulatory arrangement outlined in the text, might be in order. Moreover, because the telephone companies possess no inherent advantage in the video programming market, such regulation could likely be less restrictive of speech than is Section 533(b).

[36] The district court made conflicting statements in this regard. In the context of its discussion of this prong of intermediate scrutiny, the district court held:

> [T]here is little doubt that the statute leaves open ample alternative channels for communication. [P]laintiffs remain

Whether a regulation leaves open ample alternative methods of communication is more than an inquiry as to whether the regulation "completely silences" the speaker. Rather, for a regulation to be constitutional, the ample alternative methods of communication must be sufficiently similar to the method foreclosed by the regulation. *Cf. Clark*, 468 U.S. at 295, 104 S.Ct. at 3070 (upholding Park regulation limiting camping in park to certain areas, noting, "the Park Service neither attempts to ban sleeping generally nor to ban it everywhere in the parks").

Section 533(b) does not meet this requirement. The statute bars absolutely the telephone companies from entering, with editorial discretion, the cable television market. Appellants argue that the telephone companies have numerous alternative avenues of communication open to them: they may "arrange" to have programming of their choice transmitted to their common carrier subscribers by unaffiliated cable systems or broadcast stations or newspapers. While this may in general be true, the fact remains that the telephone companies cannot guarantee that video programming they wish to transmit to their local audience via cable television, a protected form of speech, will reach their desired audience. Appellants' accurate observation that the telephone companies may own cable systems in areas outside their areas of common carrier service does not address the problem that the telephone

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unfettered in their ability to communicate by any means other than video programming. Moreover, plaintiffs may directly provide video programming to anyone residing outside their area of service. Finally, plaintiffs may communicate with subscribers inside their service area through video programming by producing such programming and marketing it to broadcasters and cable operators.

830 F.Supp. at 926. Elsewhere, however, in its discussion of narrow tailoring, the district court observed, "There is no more draconian approach to solving the problem of potential anti-competitive practices by telephone companies in the cable television industry than a complete bar on their entry into that industry." *Id.* at 928.

companies remain unable to reach the audience of their common carrier subscribers should they so choose. While the First Amendment may tolerate speech regulations that "ban [a] particular manner or type of expression *at a given time or place*," *Ward*, 491 U.S. at 802, 109 S.Ct. at 2760 (emphasis added); *cf. Frisby v. Schultz*, *supra*, 487 U.S. at 483, 486, 108 S.Ct. at 2502, 2503 (regulation which prohibits picketing "before or about" any residence allows for ample alternative channels of communication because "[g]eneral marching through residential neighborhoods, or even walking a route in front of an entire block of houses, is not prohibited by th[e] ordinance"; reasoned the Court: "The type of focused picketing prohibited by the . . . ordinance is fundamentally different from more generally directed means of communication that may not be completely banned in residential areas."); *City of Renton v. Playtime Theatres, Inc.*, 475 U.S. 41, 53, 106 S.Ct. 925, 932, 89 L.Ed.2d 29 (1986) (city ordinance which "leaves some 520 acres, or more than five percent of the entire land are of [the city], open to use as adult theater sites" allows for reasonable alternative avenues of communication); *Clark*, 468 U.S. at 295, 104 S.Ct. at 3069-70, it does not accommodate regulations which ban completely a particular manner of expression, *see City of Ladue v. Gilleo*, —— U.S. ——, ——, 114 S.Ct. 2038, 2046, 129 L.Ed.2d 36 (1994) (even treating city ordinance which prohibits residents from placing signs on their property as a time, place or manner restriction, the ordinance did not leave open "adequate substitutes . . . for the important medium of speech that [the city] ha[d] closed off"). We conclude, therefore, that Section 533(b) does not afford the telephone companies "ample alternative channels for communication of the information" the transmission of which Section 533(b) regulates, *Clark*, 468 U.S. at 293, 104 S.Ct. at 3068-69.[37]

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[37] The appellants do not seriously suggest that the telephone companies' ability to transmit non-video programming with full

V.

Judge Tilley and Judge Russell concur in the foregoing opinion; Judge Michael concurs in the judgment herein. Judge Michael, however, dissents from the inclusion in the opinion of Section IV.A.2., which, in his opinion, is unnecessary to the decision herein.

AFFIRMED.

MICHAEL, Circuit Judge, concurring in part and concurring in the judgment:

With the exception of part IV.A.2, which discusses the applicability of "strict scrutiny," I readily concur in the majority opinion and in the judgment. I do not join part IV.A.2 because I believe it is unnecessary to the resolution of this case.

As the majority opinion explains, the government's arguments in favor of "minimal scrutiny" are unpersuasive. Section 533(b) warrants some form of heightened scrutiny. And, as the majority opinion convincingly demonstrates, § 533(b) cannot survive intermediate scrutiny: it is not narrowly tailored to achieve the alleged governmental interests and it does not leave open ample alternative avenues of communication. Because the statute cannot even withstand intermediate scrutiny, the strict scrutiny analysis in part IV.A.2 of the majority opinion is academic. *Cf. City of Ladue v. Gilleo*, —— U.S. ——, 114 S.Ct. 2038, 129 L.Ed.2d 36 (1994) (Court did not decide whether Ladue's ordinance was content-based or viewpoint-based because it concluded that the ordinance did not leave open ample alternative avenues of communication). I therefore respectfully decline to join part IV.A.2 of the majority opinion.

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editorial control serves as a channel of communication that is a viable alternative to the provision of "video programming."

APPENDIX B

UNITED STATES DISTRICT COURT
E.D. VIRGINIA
ALEXANDRIA DIVISION

Civ. No. 92-1751-A

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA, *et al.*,
Plaintiffs,

v.

UNITED STATES OF AMERICA, *et al.*,
Defendants.

NATIONAL CABLE TELEVISION ASSOCIATION, INC.,
Intervenor-Defendant.

Aug. 24, 1993

MEMORANDUM OPINION

ELLIS, District Judge.

I.

A.

Plaintiffs in this case, Chesapeake and Potomac Telephone Company of Virginia ("C & P") and Bell Atlantic Video Services Company ("BVS"), both wholly-owned subsidiaries of Bell Atlantic Corporation, challenge the constitutionality under the First Amendment of certain provisions of the Cable Communications Policy Act of 1984 (the "1984 Cable Act"), 47 U.S.C. § 521, *et*

seq. Specifically, plaintiffs challenge subsections (1) and (2) of 47 U.S.C. § 533(b) ("§ 533(b)"), which prohibit telephone companies, and their affiliates, from providing video programming to subscribers within their service areas.[1]

C & P provides local wireline telephone exchange and exchange access service in portions of Virginia, including the City of Alexandria. It is, without dispute, a common carrier subject to subchapter II of the Communications Act, and therefore subject to § 533(b). BVS is an affiliate of C & P, incorporated in Virginia on September 24, 1992, for the purpose of providing video programming to the public. C & P represents that, in the absence of § 533(b), it would enhance its telephone network in Alexandria to have the capability to carry video programming. *See* Affidavit of Richard A. Alston, C & P's Vice President of Operations & Engineering, at 1. The resulting network would have the capacity to provide several hundred channels of video programming to C & P's telephone subscribers. *Id.* at 2. C & P would make these facilities available to its affiliate, BVS, and to other video programmers under tariff on a common carrier basis. *Id.* The parties agree that existing fiber

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[1] Section 533(b) provides in relevant part:

> (1) It shall be unlawful for any common carrier, subject in whole or in part to subchapter II of this chapter, to provide video programming directly to subscribers in its telephone service area, either directly or indirectly through an affiliate owned by, operated by, controlled by, or under common control with the common carrier.
>
> (2) It shall be unlawful for any common carrier, subject in whole or in part to subchapter II of this chapter, to provide channels of communications or pole line conduit space, or other rental arrangements, to any entity which is directly or indirectly owned by, operated by, controlled by, or under common control with such common carrier, if such facilities or arrangements are to be used for, or in connection with, the provision of video programming directly to subscribers in the telephone service area of the common carrier.

optic technology is capable of providing telephone service and transmitting video programming on an integrated basis directly to subscribers. Joint Stipulation of Facts ¶ 3.

In 1992, C & P contacted the City of Alexandria government about the possibility of obtaining a cable television franchise to compete with the existing cable television operator, Jones Intercable. Alexandria's city attorney responded that, in light of § 533(b), the city would not "be in a position to grant any such franchise." Letter of Philip G. Sunderland, City Attorney, City of Alexandria, to J. Howard Middleton, Jr., Hazel & Thomas (Feb. 17, 1993). The city attorney also stated that "the city would be in a position to process a franchise application from C & P were the video programming prohibition in 47 U.S.C. 533(b) removed." *Id.* Alexandria's mayor has submitted an affidavit indicating her support of C & P's proposal, and indicating that, absent § 533(b), C & P's application for a cable television franchise would receive the same consideration as would be accorded any other applicant. *See* Affidavit of Patricia S. Ticer at 2.

Plaintiffs filed the complaint in the instant action on December 17, 1992, challenging § 533(b) as violative of the First Amendment of the United States Constitution, both facially and as applied to their proposed provision of video programming in the City of Alexandria. Because this is a constitutional challenge to a federal statute, plaintiffs have named as defendants the United States of America, the Federal Communications Commission (the "Commission") and William P. Barr, in his official capacity as Attorney General of the United States [2] (collectively, the "government"). On motion, the National Cable Television Association, Inc. ("NCTA") was permitted to intervene in support of the statute's constitu-

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[2] By a *sua sponte* Order of the Court, Janet Reno has been substituted for William Barr.

tionality. NCTA accordingly participated in virtually every phase of the litigation, including submission of briefs, preparation of the stipulation of facts, and presentation of oral argument. Less extensive was the participation of thirty-three *amici curiae*,[3] who were limited to submission of briefs.

After pursuing some formal discovery, the parties, at the Court's invitation, explored the possibility of submitting the matter to the Court on cross-motions for summary judgment by completing discovery informally and cooperatively and undertaking to prepare a joint stipulation of facts. The effort bore fruit. The matter is now before the Court on cross-motions for summary judgment based on a comprehensive stipulation of facts and a supporting record consisting of several thousand pages of affidavits, exhibits, and briefs. Indeed, it is difficult to imagine a more complete record, and it is hard to see how the Court's disposition of the dispute on this record can reasonably be labeled as "summary."

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[3] The *amici curiae* are: National Association of Broadcasters; Association of Independent Television Stations, Inc.; Tribune Broadcasting Company; Citizens for a Sound Economy Foundation; American Legislative Exchange Council; United States Telephone Association; Ameritech; BellSouth Corporation; Contel of Virginia, Inc. d/b/a GTE Virginia; GTE Service Corporation; NYNEX Corporation; Pacific Telesis Group; Rochester Telephone Corporation; Southwestern Bell Corporation; US WEST Inc.; Consumer Federation of America; Virginia Citizens Consumer Council; Newspaper Association of America; Virginia Press Association; METS Fans United/Virginia Consumers for Cable Choice; Alexandria Federation of Civic Associations, Inc.; Virginia State Conference NAACP; Virginia Association for the Deaf; Northern Virginia Resource Center for Deaf and Hard of Hearing Persons; Virginia Public Interest Coalition; Men's Senior Baseball League; Harlem Consumer Education Council; Pennsylvania Institute for Community Services; Mobile Community Action, Inc.; Self Help Action of Chicago; American Council of Consumer Awareness, Inc.; Colorado River Community Action Council; and New Opportunities for Waterbury, Inc.

B.

Although § 533(b) was enacted as part of the 1984 Cable Act, telephone companies have been prohibited from providing cable television service since the early years of the cable television industry. Section 533(b) had its genesis in a similar restriction imposed by the Commission in 1970. At that time, the cable television industry was in its infancy and was referred to as community antenna television service ("CATV"). The then-existing technology entailed building large antennas in rural areas and other places unable to receive clear television signals over the air, and stringing cables, often on electric utility or telephone poles, from the central antenna to the CATV customers. In 1968, the Commission ruled that telephone companies must obtain certification pursuant to § 214 of the Communications Act, 47 U.S.C. § 214, prior to constructing, acquiring or operating facilities to provide "channel service" to cable television companies.[4] Because the resulting § 214 applications revealed varying degrees of ownership affiliation between telephone companies and cable television operators, the Commission initiated a rule-making proceeding to ascertain whether telephone companies, either directly or

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[4] *See General Telephone Co. of California*, 13 F.C.C.2d 448 (1968), *aff'd sub nom. General Telephone Co. of California v. FCC*, 413 F.2d 390 (D.C.Cir.), *cert. denied*, 396 U.S. 888, 90 S.Ct. 173, 24 L.Ed.2d 163 (1969).

Section 214 provides in relevant part:

> No carrier shall undertake the construction of a new line or of an extension of any line, or shall acquire or operate any line, or extension thereof, or shall engage in transmission over or by means of such additional or extended line, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require the construction, or operation, or construction and operation, of such additional or extended line. . . .

47 U.S.C. § 214(a).

through affiliates, should be permitted to provide cable television service to the public.[5] As a result of this proceeding, the Commission concluded that telephone companies and their affiliates should be precluded, absent specific exemption, from providing cable television service within their local telephone service areas.[6] The Commission based its ruling on a finding that the telephone companies had the potential to discriminate against independent CATV providers, in favor of telephone company affiliates, in granting access tc telephone poles for attachment of the CATV cables.[7]

In 1978, Congress passed the Pole Attachment Act, which authorized the Commission to "regulate the rates, terms, and conditions for pole attachments." 47 U.S.C. § 224(b)(1). Although this legislation addressed cable operators' fears of discriminatory pricing for pole attachments, the legislation is, by its terms, applicable only if access to poles is actually granted by the owner; it does not mandate such access. *See FCC v. Florida Power Corp.*, 480 U.S. 245, 251, 107 S.Ct. 1107, 1111, 94 L.Ed.2d 282 (1987). Thus, the Pole Attachment Act only partially allayed the Commission's concerns regard-

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[5] *See Applications of Telephone Common Carriers for Section 214 Certificates for Channel Facilities Furnished to Affiliated Community Antenna Television Systems (Notice of Proposed Rule Making)*, 34 Fed.Reg. 6290 (1969).

[6] *See Applications of Telephone Common Carriers for Section 214 Certificates for Channel Facilities Furnished to Affiliated Community Antenna Television Systems (Final Report and Order)* (the "1970 Order"), 21 F.C.C.2d 307 (1970), *recons. in part*, 22 F.C.C.2d 746 (1970), *aff'd sub nom. General Telephone Co. of the Southwest v. United States*, 449 F.2d 846 (5th Cir.1971). Significantly, the court challenge to the 1970 Order did not involve a First Amendment claim.

[7] *See* 1970 Order, 21 F.C.C.2d at 324. ("[T]he monopoly position of the telephone company in the community [results in] effective control of the pole lines (or conduit space) required for the construction and operation of CATV systems. Hence, the telephone company is in an effective position to preempt the market for this service. . . .").

ing cable operators' access to telephone poles and conduit space.

In 1980, the Commission directed its staff to conduct a study of the Commission's cable television cross-ownership policies. This directive culminated in the issuance of a report by the FCC Office of Plans and Policy in November 1981, entitled *FCC Policy on Cable Ownership, A Staff Report* (the "OPP Report"). The OPP Report considered alternatives to the then-existing Commission policy against telephone company provision of cable television, but concluded by advising that the restriction "must be retained for the time being." OPP Report at 143. The report, while acknowledging that "the problem of pole access" would no longer "by itself" justify the restriction, *id.* at 162, found that additional concerns, noted but not relied upon by the Commission when it had originally implemented the ban, continued to militate aaginst removing the restriction. Chief among these concerns was "cross-subsidization," namely the possibility that telephone companies operating cable television facilities would hide cable costs in their telephone rate bases. Such cross-subsidization "allow[s] a telephone company partially to avoid rate-of-return regulation on its telephone service . . . by attributing costs to the regulated telephone division and revenues to an unregulated cable division" *Id.* at 153. Unchecked, this practice would lead to higher telephone rates and supra-competitive profits for the telephone companies. *Id.* at 158. Such profits, in turn, could be used to underprice competing cable television operators, forcing them out of business, thereby enabling the telephone companies to leverage their regulated local exchange monopoly into an additional monopoly of video transmission services. The Commission took no formal action following release of the OPP Report either to approve or reject the report. The Commission's restriction on telephone companies' provision of cable television within their service areas was retained without modification.

In 1984, Congress passed the 1984 Cable Act, which includes the provisions at issue in this case. Section 533 (b) was adapted directly from the regulations established by the Commission's 1970 Order, with the exception that where the Commission had prohibited telephone company provision of "CATV service," the new law prohibited provision of "video programming," defined as "programming provided by, or generally considered comparable to programming provided by, a television broadcast station." 47 U.S.C. § 522(19). Congress also included, as had the Commission's regulations, a rural exemption and waiver authority for the Commission. *See* 47 U.S.C. § 533(b)(3) and (4).

Legislative materials relating to § 533(b) are sparse. No legislative findings of fact accompanied the provisions. The sole specific reference to § 533(b) in the legislative history of the 1984 Cable Act is a passage in the House Committee Report, which indicates that the intent of the provision was "to codify current FCC rules concerning the provision of video programming over cable systems by common carriers. . . ." H.R.Rep. No. 934, 98th Cong., 2d Sess. 56 (1984), U.S.Code Cong. & Admin.News 1984, pp. 4655, 4693. The report indicates that § 533 as a whole, which also includes a prohibition on cross-ownership between television stations and cable systems in the same geographical area (and, in the version of the bill reported by the House of Representatives but not in the final version of the statute, a provision preventing cross-ownership between daily newspapers and cable systems in the same geographical area) was intended "to prevent the development of local media monopolies, and to encourage a diversity of ownership of communications outlets." *Id.* at 55, U.S.Code Cong. & Admin.News 1984, p. 4692.

In August 1986, less than two years after Congress enacted § 533(b), the Commission directed its Common Carrier Bureau to prepare a notice of inquiry "on the question of the restriction on cable ownership placed on local exchange telephone companies." 1 FCC Rcd. 864,

897 (1986). A formal Notice of Inquiry was issued a year later, *In re Telephone Company—Cable Television Cross-Ownership Rules (Notice of Inquiry)*, 2 FCC Rcd. 5092 (1987), and was followed by a Further Notice of Inquiry and Notice of Proposed Rulemaking released in September 1988. *In re Telephone Company—Cable Television Cross-Ownership Rules (Further Notice of Inquiry and Notice of Proposed Rulemaking)* (the "FNOI"), 3 FCC Rcd. 5849 (1988). In the FNOI, the Commission tentatively concluded that it should recommend to Congress that § 533(b) be eliminated.

In August 1992, after soliciting a further round of comments, the Commission finally acted on its tentative conclusion, recommending formally to Congress "that it amend the Cable Act to permit the local telephone companies to provide video programming directly to subscribers in their telephone service areas, subject to appropriate safeguards." *In re Telephone Company—Cable Television Cross-Ownership Rules (Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking)* (the "Video Dialtone Order"), 7 FCC Rcd. 5781, 5847 (1992). The Commission concluded that "the risks of anticompetitive conduct by the local telephone companies in connection with the direct provision of video programming have been attenuated by the enormous growth of the cable industry," with the result that "any remaining risk of anticompetitive conduct by the local telephone companies is outweighed by the potential public interest benefits their entry would bring." *Id.* at 5848-49. As a consequence, the Commission found that elimination of § 533(b) would "promote our overarching goals in this proceeding by increasing competition in the video marketplace, spurring the investment necessary to deploy an advanced infrastructure, and increasing the diversity of services available to the public." *Id.* at 5847.[8]

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[8] Ironically, despite the fact that the Department of Justice is the principal litigant defending the validity of § 533(b) in this

Throughout the period the Commission was considering the issue of telephone company entry into the cable television business, Congress itself was devoting extensive attention to the matter. Repeal of § 533(b) has been considered in numerous Congressional hearings,[9] and pro-

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proceeding, the Department's Antitrust Division also supports repeal of the provision. *See* Reply Comments of the United States Department of Justice, *In re Telephone Company—Cable Television Cross-Ownership Rules*, CC Docket No. 87-266, p. 44 ("The Department believes that LECs [local exchange carriers] should be allowed to own and directly provide video programming."). Another federal agency, the National Telecommunications and Information Administration ("NTIA") of the Department of Commerce has reached the same conclusion. *See*, Comments of NTIA, *In Re Telephone Company—Cable Television Cross-Ownership Rules*, CC Docket No. 87-266, pp. 2-3.

[9] *See Cable Instructional TV and S. 1200 Communications Competitiveness and Infrastructure Modernization Act of 1991: Hearings Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science and Transportation*, 102d Cong., 2d Sess. (February 28, 1992); *Cable TV Consumer Protection Act of 1991: Hearings Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science and Transportation*, 102d Cong., 1st Sess. (March 14, 1991); *Cable Television Regulation: Hearings Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 102d Cong., 1st Sess. (March 20 and June 26, 1991); *Communications Competitiveness and Infrastructure Modernization Act of 1990: Hearings Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science, and Transportation*, 101st Cong., 2d Sess. (July 24, 1990); *Cable TV Consumer Protection Act of 1989: Hearings Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science, and Transportation*, 101st Cong., 2d Sess. (March 29 and April 4, 1990); *Cable Television Regulations: Hearings Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, (Parts 1 and 2)*, 101st Cong., 2d Sess. (March 1, April 19, and May 9, 1990); *Oversight of Cable TV: Hearings Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science and Transportation*, 101st Cong., 1st Sess. (November 17, 1989); *Competitive Issues in the Cable Television Industry: Hearings Before the Subcomm. on Antitrust, Monopolies and Business Rights of the Senate Comm. on the Judiciary*, 100th Cong., 2d Sess. (March 17, 1988).

posals to eliminate the statute have appeared in six separate bills since 1989.[10] To date, Congress has declined to modify the provision, despite the recommendation of the Commission, and despite the interim passage of the Cable Television Consumer Protection and Completion Act of 1992 (the "1992 Cable Act"), which comprehensively revised regulation of the cable television industry. The Senate Report accompanying the 1992 Cable Act expressly affirmed the Committee's belief that the § 533 (b) ban "enhance[d] competition." *See* S.Rep. No. 92, 102d Cong., 1st Sess. 18 (1991), U.S.Code Cong. & Admin.News 1992, pp. 1133, 1150.

C.

Cable television has changed dramatically since the Commission originally banned telephone companies from participation in the industry in 1970. At that time, CATV reached only approximately 9% of all homes and mainly consisted of small, limited capacity systems in remote communities. *See* Video Dialtone Order, 7 FCC Rcd. at 5848; Joint Stipulation of Facts ¶ 17. Now, cable television is available to over 96% of the nation's homes, and approximately 60% of the television households subscribe. *Id.*

Cable systems carry both the programming of broadcast television stations and programming made by or directly marketed to cable operators. In recent years, the amount of non-broadcast video programming has increased markedly. As of 1992, there were 78 national cable networks, up from only four in 1976. Joint Stipulation of Facts ¶ 9. Cable systems nationwide currently have an average capacity of about 40 channels. *Id.* at ¶ 20. As the parties have stipulated, "the supply of available video

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[10] *See* H.R. 1504, 103rd Cong., 1st Sess. (1993); S. 1200, 102d Cong., 1st Sess. (1991); H.R. 2546, 102d Cong., 1st Sess. (1991); S. 2800, 101st Cong., 2d Sess. (1990); S. 1068, 101st Cong., 1st Sess. (1989); H.R. 2437, 101st Cong., 1st Sess. (1989).

programming exceeds the available channel capacity of almost all cable systems." *Id.* at ¶ 19.

Companies operating cable television systems have grown rapidly, commensurate with the growth of the industry. According to the Census Bureau, annual cable operator revenues were $345 million in 1970. *Id.* at ¶ 27. By 1992, annual revenues of the industry topped $21 billion. *Id.* Many cable systems serving individual communities are owned by large, national or regional chains known as multiple system operators ("MSOs"). The five largest MSOs combined to serve over 40% of all cable subscribers. *Id.* at ¶ 29. The largest MSO, Tele-Communications, Inc., served 9.6 million cable subscribers in 1991 and had revenues of $3.8 billion. The second largest, Time Warner, had 6.8 million subscribers and total revenue from all sources of $12 billion. *Id.* at ¶ 31.

Despite Congressional efforts to promote competition in the cable industry, the provision of cable television has remained a monopoly service in virtually every community. In 1991, cable system operators faced competition from another operator in less than 1% of the localities served by cable. *Id.* at ¶ 28.

In Alexandria, the sole provider of cable television service is Jones Intercable, the country's eighth largest MSO. *Id.* at ¶ 32. Cable service is available to over 90% of all television households in Alexandria, and 57% of television households subscribe. *Id.* at ¶ 18. The system deployed in Alexandria has a capacity of 51 channels, and, as of April 1993, Jones Intercable offered a programming package of 44 channels for $24.65 per month. *Id.* at ¶¶ 21, 34. Plaintiffs note that in nearby Anne Arundel County, Maryland, where Jones Intercable faces competition from another cable service, the company charges only $21.20 per month for a comparable programming package; cable subscribership in Anne Arundel County is over 70%. *Id.* at ¶¶ 34-35.

II.

As a preliminary matter, the government disputes plaintiffs' standing to bring a challenge to § 533(b). Specifically, the government argues that plaintiffs' injury, the inability to provide cable television service within C & P's service area, is neither "traceable" to § 533(b) nor "likely to be redressed" by a decision invalidating § 533 (b). This contention is meritless.

In order to establish standing, at an "irreducible constitutional minimum," plaintiffs must show three elements:

> First, the plaintiff must have suffered an "injury in fact"—an invasion of a legally-protected interest which is (a) concrete and particularized . . .; and (b) "actual or imminent, not 'conjectural' or 'hypothetical,' ". . . . Second, there must be a casual connection between the injury and the conduct complained of—the injury has to be "fairly trace[able] to the challenged action of the defendant, and not . . . th[e] result [of] the independent action of some third party not before the court.". . . . Third, it must be "likely," as opposed to merely "speculative," that the injury will be "redressed by a favorable decision."

Lujan v. Defenders of Wildlife, —— U.S. ——, ——, 112 S.Ct. 2130, 2136, 119 L.Ed.2d 351 (1992) (internal citations omitted). Indisputably, the ban on provision of video programming inflicts a concrete, actual injury on plaintiffs. Moreover, contrary to the government's contention, the injury is also "traceable" to the § 533(b) ban and would be redressed by invalidation of the ban.

At the heart of the government's standing argument is the observation that if § 533(b) were lifted, plaintiffs would not instantly be in a position to provide cable television. In support, the government notes that plaintiffs have obtained neither approval from the Virginia State Corporation Commission nor a franchise from the

City of Alexandria to operate a cable television system. Thus, the government contends, plaintiffs' inability to provide cable television is not traceable solely to § 533(b), and invalidation of § 533(b) would not necessarily redress the purported injury that plaintiffs have suffered.

The fallacy of this argument is that it is not an essential precondition of plaintiffs' standing that the challenged statute be the sole obstacle to plaintiffs' achievement of their ultimate goal.[11] The fact that § 533(b) stands as an "absolute barrier" to plaintiffs' efforts to operate a cable television service is sufficient, by itself, to satisfy the traceability requirement. *See Arlington Heights*, 429 U.S. at 261, 97 S.Ct. at 561. Similarly, plaintiffs satisfy the requirement that their injury would be "redressed by a favorable decision," simply because invalidation of the statute would allow plaintiffs to pursue regulatory approval and a municipal franchise on the same footing as any other applicant. *See Regents of University of California v. Bakke*, 438 U.S. 265, 281 n. 14, 98 S.Ct. 2733, 2743 n. 14, 57 L.Ed.2d 750 (1978) (standing exists for plaintiff unconstitutionally deprived of opportunity to *compete* for a benefit, without proof that, in the absence of the challenged program, plaintiff necessarily would have received the benefit).

It would be both formalistic and wasteful of governmental and societal resources to require, as the government suggests is necessary, that plaintiffs engage in a doomed effort to obtain a municipal franchise and state

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[11] *See Arlington Heights v. Metropolitan Housing Development Corp.*, 429 U.S. 252, 261, 97 S.Ct. 555, 561, 50 L.Ed.2d 450 (1977) (standing exists where challenged statute was "absolute barrier" to plaintiff's goal, despite the fact that invalidation of statute would not "guarantee" achievement of that goal); *see also Nyquist v. Mauclet*, 432 U.S. 1, 6 n. 7, 97 S.Ct. 2120, 2124 n. 7, 53 L.Ed.2d 63 (1977) (unnecessary for plaintiff to apply for and be denied a loan in order to establish his standing to challenge the statute making him ineligible for the loan, "in light of the certainty of [the loan's] denial" under the statutory scheme).

regulatory approval for their venture, even in the face of a federal statute that expressly forbids them from engaging in the activity in question. The futility of any such undertaking is underscored by the predictable response of the Alexandria city government, which refused, in light of § 533(b), to consider C & P's preliminary efforts to obtain a municipal franchise. *See* Letter of Philip G. Sunderland, City Attorney, City of Alexandria, to J. Howard Middleton, Jr., Hazel & Thomas (Feb. 17, 1993).

In essence, it is the government's position that C & P, a local telephone company, does not have standing to challenge a statute that expressly and exclusively restricts the activities of local telephone companies. Such a contention is manifestly against the thrust of the Supreme Court's decisions on standing,[12] and is therefore rejected. Plaintiffs have proper standing to bring this action.

III.

A.

The fundamental constitutional question that must be addressed in relation to plaintiffs' First Amendment claim is the appropriate level of judicial scrutiny to be applied to § 533(b). Generally, regulations that are alleged to infringe upon speech protected under the First Amendment are subjected to one of two levels of scrutiny. First, the "strict scrutiny" standard is applicable to content-based regulations. This is the most stringent standard, for "[t]he First Amendment generally prevents government from proscribing speech, or even expressive conduct,

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[12] *See, e.g., Lujan,* —— U.S. at ——, 112 S.Ct. at 2137 ("When the suit is one challenging the legality of government action or inaction, the nature and extent of facts that must be averred (at the summary judgment stage) or proved (at the trial stage) in order to establish standing depends considerably upon whether the plaintiff is himself an object of the action (or forgone action) at issue. If he is, there is ordinarily little question that the action or inaction has caused him injury, and that a judgment preventing or requiring the action will redress it.").

because of disapproval of the ideas expressed." *R.A.V. v. City of St. Paul*, —— U.S. ——, ——, 112 S.Ct. 2538, 2542, 120 L.Ed.2d 305 (1992) (internal citations omitted). As a result, "content-based regulations are presumptively invalid." *Id.* A content-based regulation can survive only if the government " 'show[s] that its regulation is necessary to serve a compelling state interest and is narrowly drawn to achieve that end.' " *Simon & Schuster, Inc. v. Members of New York State Crime Victims Board*, —— U.S. ——, ——, 112 S.Ct. 501, 509, 116 L.Ed.2d 476 (1991) (quoting *Arkansas Writers' Project, Inc. v. Ragland*, 481 U.S. 221, 231, 107 S.Ct. 1722, 1728, 95 L.Ed.2d 209 (1987)).

Regulations that are not content-based, but which still infringe upon protected speech may be accorded a lower, "intermediate" level of scrutiny. Thus, the government may, "impose reasonable restrictions on the time, place, or manner of protected speech" without triggering strict scrutiny, provided, *inter alia*, that such restrictions are content-neutral. *Ward v. Rock Against Racism*, 491 U.S. 781, 789-90, 109 S.Ct. 2746, 2753, 105 L.Ed.2d 661 (1989). Similarly, the government may regulate conduct, even when such conduct has an expressive element, provided that it does not "proscribe particular conduct *because* it has expressive elements." *Texas v. Johnson*, 491 U.S. 397, 406, 109 S.Ct. 2533, 2540, 105 L.Ed.2d 342 (1989). The Supreme Court has ruled that either type of content-neutral regulation will survive scrutiny under the First Amendment if the provisions in question pass the test first enunicated in *United States v. O'Brien*, 391 U.S. 367, 377, 88 S.Ct. 1673, 1679, 20 L.Ed.2d 672 (1968), and refined in later decisions, namely, that the provisions " 'are justified without reference to the content of the regulated speech, that they are narrowly tailored to serve a significant governmental interest, and that they leave open ample alternative channels for communication of the information.' " *Ward*, 491 U.S. at 791, 109 S.Ct. at 2753 (quoting *Clark v. Community*

for Creative Non-Violence, 468 U.S. 288, 293, 104 S.Ct. 3065, 3069, 82 L.Ed.2d 221 (1984)); *see also Community for Creative Non-Violence*, 468 U.S. at 298, 104 S.Ct. at 3071 (indicating that the constitutional test for the validity of time, place, or manner restrictions is "in the last analysis . . . little, if any, different from" the test for restrictions on expressive conduct).

Defendants in this matter forcefully contend that the provisions in question should not be subjected to either of the two forms of heightened review applicable in the First Amendment context. Instead, defendants argue that § 533(b) is an example of "structural" economic regulation, only tangentially related to the First Amendment and, therefore, that § 533(b) should be subjected only to rationality review, that is, that this Court must uphold the provision if it is rationally related to a legitimate government objective. At most, defendants argue, the provision places only an incidental burden on the plaintiffs' First Amendment rights and therefore should be subjected to intermediate scrutiny under the *O'Brien* test.

Plaintiffs reject this view and argue instead that § 533(b) is a direct infringement on their right to speak in a particular forum, thereby directly implicating First Amendment considerations. Moreover, plaintiffs contend that § 533(b) is a content-based restriction on speech and therefore, under Supreme Court precedent, is subject to strict scrutiny. At the least, plaintiffs contend, even if § 533(b) is found to be content-neutral, the incidental burden on plaintiffs' speech necessitates review of the statute under the *O'Brien* test.

Plaintiffs' argument is correct in an important respect; the provision in question must be subjected to a higher standard than mere "rationality review." Section 533(b) directly abridges the plaintiffs' right to express ideas by means of a particular, and significant, mode of communication—video programming. Video programming, as offered by cable operators, has been recognized by the Supreme Court as a form of speech protectible under the

First Amendment. *See Leathers v. Medlock*, 499 U.S. 439, ——, 111 S.Ct. 1438, 1442, 113 L.Ed.2d 494 (1991) ("Cable television . . . is engaged in 'speech' under the First Amendment"); *City of Los Angeles v. Preferred Communications, Inc.*, 476 U.S. 488, 494, 106 S.Ct. 2034, 2037, 90 L.Ed.2d 480 (1986) ("[T]hrough original programming or by exercising editorial discretion over which stations or programs to include in its repertoire, [a cable television operator] seeks to communicate messages on a wide variety of topics and in a wide variety of formats."). As such, a statute that directly abridges the right to engage in this form of speech must be evaluated under the heightened standards that have evolved under the Supreme Court's First Amendment decisions. This is true even when the abridgement is an incidental effect of a statute directed at non-speech activity, such as "structural" economic regulation, if such a statute disproportionately impacts entities engaged in speech protected by the First Amendment. *See, e.g., Arcara v. Cloud Books, Inc.*, 478 U.S. 697, 704, 106 S.Ct. 3172, 3176, 92 L.Ed.2d 568 (1986).

Defendants' authorities in support of rationality review are all distinguishable. With one exception,[13] the cases cited in support of this position deal with regulations directed at the broadcast media. *See FCC v. National Citizens Committee for Broadcasting*, 436 U.S. 775, 98 S.Ct. 2096, 56 L.Ed.2d 697 (1978); *United States v. Midwest Video Corp.*, 406 U.S. 649, 92 S.Ct. 1860, 32 L.Ed.2d 390 (1972); *National Broadcasting Co. v. United States*, 319 U.S. 190, 63 S.Ct. 997, 87 L.Ed. 1344 (1943). In each of these cases, the Supreme Court explicitly premised its ruling on the fact that there is a physical scarcity of electromagnetic frequencies available for utilization by prospective broadcasters. *See, e.g., National Broadcasting Co.*, 319 U.S. at 226, 63 S.Ct. at 1014 ("Unlike other modes of expression, radio inher-

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[13] *Associated Press v. United States*, 326 U.S. 1, 65 S.Ct. 1416, 89 L.Ed. 2013 (1945), discussed *infra*.

ently is not available to all. That is its unique characteristic, and that is why, unlike other modes of expression, it is subject to governmental regulation."); *see also Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 89 S.Ct. 1794, 23 L.Ed.2d 371 (1969). In light of the physical scarcity of electromagnetic frequencies, the Supreme Court has accorded Congress greater latitude under the First Amendment to regulate broadcasters than other forms of communication media, to ensure that the "public interest" is served. *See, e.g., National Citizens Committee*, 436 U.S. at 795, 98 S.Ct. at 2112.

Of course, viewing only the end product, cable television is largely indistinguishable from broadcast television. Yet enormous differences in the technology used to convey the respective forms of communication clearly warrant different treatment of cable television under the First Amendment. *See, e.g., Southeastern Promotions Ltd. v. Conrad*, 420 U.S. 546, 557, 95 S.Ct. 1239, 1246, 43 L.Ed.2d 448 (1975) ("Each medium of expression . . . must be assessed for First Amendment purposes by standards suited to it, for each may present its own problems."). As the parties have stipulated, "There are no absolute physical barriers to the construction of competing multichannel cable services attributable to the physical scarcity of the electromagnetic spectrum." Joint Stipulations of Fact, ¶ 37. Moreover, while there may, at some point, exist an absolute physical constraint on the number of cables that could be strung along existing utility rights-of-way in order to service individual households, the number of cable operators that could simultaneously service a household is so large as to be infinite for purposes of First Amendment analysis.[14]

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[14] *See* Joint Stipulation of Fact, ¶ 40 ("In general, multiple lines of coaxial cable or fiber optics can be placed next to each other without mutual interference to video signals they carry. This means competing cable transmission systems can exist side-by-side without such interference.").

The only scarcity argument that defendants could legitimately advance to make the broadcasting cases apposite is that the cable television industry is a natural monopoly and, therefore, that certain economic factors conspire to create a condition of scarcity in the market for cable television analogous to the scarcity imposed on broadcasting by the physical properties of the electromagnetic spectrum. This argument has been foreclosed, however, by the Supreme Court's decision in *Miami Herald Publishing Co. v. Tornillo*, 418 U.S. 241, 94 S.Ct. 2831, 41 L.Ed.2d 730 (1974). There, the Supreme Court struck down a state statute requiring a newspaper, under certain circumstances, to publish an editorial reply by a candidate who had been assailed in the newspaper. The statute in question was similar, in its requirement of mandated access, to the Commission's "fairness doctrine," applicable to radio broadcasters, which had been upheld in *Red Lion*, 395 U.S. at 367, 89 S.Ct. at 1794. Significantly, the Supreme Court struck down the statute despite accepting the assumption that there had evolved a "monopoly of the means of communication" and citing a study finding that " '[o]ne-newspaper towns have become the rule, with effective competition operating in only 4 percent of our large cities.' " *Tornillo*, 418 U.S. at 249-50 & n. 13, 94 S.Ct. at 2835-36 & n. 13. The clear implication of *Tornillo* is that the principle that allows an increased level of government intervention under conditions of physical scarcity is inapplicable when scarcity results from purely economic forces. As a result, an assertion that the cable television industry is a natural monopoly is insufficient to bring the present case within the ambit of the broadcast cases.[15]

While defendants cannot argue scarcity, they make a related argument, namely that, as beneficiaries of a gov-

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[15] For a more extensive discussion of the inapplicability of the scarcity doctrine to regulation of cable television, *see Home Box Office, Inc. v. FCC*, 567 F.2d 9, 43-46 (D.C.Cir.), *cert. denied*, 434 U.S. 829, 98 S.Ct. 111, 54 L.Ed.2d 89 (1977).

ernment-sanctioned monopoly for the provision of local wireline telephone exchange services, plaintiffs may have their right to continued status as a monopoly subjected to certain conditions imposed by the government. It is permissible, defendants contend, that among those conditions the government require that the plaintiffs refrain from providing video programming to customers within their service areas. Defendants argue that, in effect, plaintiffs have a choice: in any given area, they may provide video programming or local telephone service; they may not do both. Thus, § 533(b) does not absolutely preclude plaintiffs from offering video programming—if they wish to do so, they simply must abandon their local wireline exchange monopoly.

It is unnecessary, in the context of this litigation, to reach the thorny legal question of when, and under what circumstances, the government may condition a benefit upon the beneficiary's relinquishment of a constitutional right.[16] Section 533(b) is simply not part of a *quid pro quo* exchange in which the telephone com-

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[16] *Compare, e.g., Buckley v. Valeo*, 424 U.S. 1, 57 & n. 65, 96 S.Ct. 612, 653 & n. 65, 46 L.Ed.2d 659 (1976) (indicating that law imposing campaign spending limits was unconstitutional abridgement of a candidate's freedom of speech, but that Congress could condition the candidate's acceptance of public financing on an agreement to abide by such spending limits) *with, e.g., Perry v. Sindermann*, 408 U.S. 593, 597, 92 S.Ct. 2694, 2697, 33 L.Ed.2d 570 (1972) ("[E]ven though a person has no 'right' to a valuable governmental benefit and even though the government may deny him the benefit for any number of reasons, there are some reasons upon which the government may not rely. It may not deny a benefit to a person on a basis that infringes his constitutionally protected interests—especially, his interest in freedom of speech."). *See also Rust v. Sullivan*, —— U.S. ——, ——-——, 111 S.Ct. 1759, 1774-76, 114 L.Ed.2d 233. This area of the law has spawned a great deal of academic interest. *See, e.g.*, David Cole, *Beyond Unconstitutional Conditions: Charting Spheres of Neutrality in Government Funded Speech*, 67 N.Y.U.L.Rev. 675 (1992); Kathleen M. Sullivan, *Unconstitutional Conditions*, 102 Harv.L.Rev. 1415 (1989).

panies were offered the opportunity to operate a monopoly service in return for accepting restrictions on their First Amendment rights. To be sure, "the BOCs [Bell Operating Companies] have monopolies over local telephone exchange service in their respective service areas." *United States v. Western Electric Co.*, 993 F.2d 1572, 1578 (D.C.Cir.1993). Similarly, there is no question that in this jurisdiction, as in most others, the state government has taken actions to preserve the local exchange monopoly of the BOC.[17] Even so, defendants' *quid pro quo* argument is unpersuasive.

First, the sovereign which purportedly provided the benefit to the plaintiffs is not the same sovereign that placed the condition on the benefit. As noted above, it is the Commonwealth of Virginia that has legislated in support of the plaintiffs' local exchange monopoly. In no way can defendants persuasively argue that the federal government has sanctioned plaintiffs' monopoly. Far from it, the record reflects vigorous steps by the federal government to minimize the anti-competitive consequences of the local exchange monopoly.[18] Having pro-

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[17] *See* Virginia Code § 56-265.4:4(A) ("No certificate shall be granted to an applicant proposing to furnish local exchange telephone service in the territory of another certificate holder unless and until it shall be proved to the satisfaction of the Commission that the service rendered by such certificate holder in such territory is inadequate to the requirements of the public necessity and convenience. If the Commission shall be of the opinion that the service rendered by the existing certificate holder in such territory is in any respect inadequate to the requirements of the public necessity and convenience, that certificate holder shall be given reasonable time and opportunity to remedy the inadequacy before any certificate shall be granted to an applicant proposing to operate in that territory.").

[18] In this regard, plaintiffs point to recent technological advances, encouraged by the FCC, which have provided individuals with increasing opportunities to utilize communication methods that would bypass the BOC's exchange networks. Examples include

vided no benefit to plaintiffs, the federal government cannot be heard to argue that, by restricting the plaintiffs' First Amendment rights, it has merely placed a condition on a benefit it has granted. *Cf. First National Bank of Boston v. Bellotti*, 435 U.S. 765, 778-79 n. 14, 98 S.Ct. 1407, 1416-17 n. 14, 55 L.Ed.2d 707 (1978) (restriction imposed by one sovereign cannot be justified by grant of benefit by different sovereign).

Nor was § 533(b) a condition of plaintiffs accepting the local exchange monopoly. The state government sanctioned plaintiffs regulated monopoly long before, and for reasons unrelated to, the federal government's passage of § 533(b). In no way is there a *quid pro quo* relationship between § 533(b) and the local exchange monopoly.

Besides, the Supreme Court has given no indication that any government's grant of monopoly status to an

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the establishment of Competitive Access Providers employing fiber-optic or microwave technologies, the licensing of increasing numbers of cellular phone service providers, and the experimental licensing of additional radio-based telephone providers offering personal communication services. *See* Joint Stipulation of Facts, ¶¶ 47, 53, 55. Even more indicative of the federal government's antipathy toward the BOC's monopoly of local exchange services is the AT & T consent decree litigation, brought by the Department of Justice, which resulted in the divestiture by AT & T of the BOCs. Contrary to the defendants' contention that the Modified Final Judgment ("MFJ") entered by Judge Greene in *United States v. American Telephone & Telegraph Co.*, 552 F.Supp. 131 (D.D.C.1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001, 103 S.Ct. 1240, 75 L.Ed.2d 472 (1983), signals the federal government's complicity in the existence of the BOC's monopoly, the "very purpose" of the MFJ was to prevent the operator of the local exchange monopoly (which, prior to the litigation, was AT & T) from leveraging its monopoly into other, potentially competitive, markets in the communications industry—most significantly, the interexchange (long distance) transportation of communication services. *Id.* at 188. Judge Greene explicitly recognized, and approved of, the fact that evolving technology would likely result in an eventual challenge to the BOCs' monopoly of local exchange services. *Id.* at 175.

entity is sufficient to allow it to restrict that entity's First Amendment rights. Indeed, its decisions suggest the contrary. *See Central Hudson Gas & Electric Corp. v. Public Service Commission of New York*, 447 U.S. 557, 568, 100 S.Ct. 2343, 2352, 65 L.Ed.2d 341 (1980) ("appellant's monopoly position does not alter the First Amendment's protection for its commercial speech"); *Consolidated Edison Co. v. Public Service Commission of New York*, 447 U.S. 530, 534 n. 1, 100 S.Ct. 2326, 2331 n. 1, 65 L.Ed.2d 319 (1980) ("Nor does [appellant's] status as a privately owned but government regulated monopoly preclude its assertion of First Amendment rights."). Taken to its logical extreme, defendants' argument would mean that because state governments have chosen to confer certain advantages on businesses that opt to incorporate, any corporate speaker is, as a beneficiary of those advantages, subject to having conditions placed on its right to free speech. This proposition has flatly been rejected by the Supreme Court. *See Bellotti*, 435 U.S. at 778-79 n. 14, 98 S.Ct. at 1416-17 n. 14. Accordingly, this Court rejects defendants' argument that § 533(b) may be characterized as a *quid pro quo* exchange of monopoly benefits in return for acceptance of First Amendment restrictions and, therefore, that the provision need only be accorded rationality review.

The last case defendants cite in support of rationality review is *Associated Press v. United States*, 326 U.S. 1, 65 S.Ct. 1416, 89 L.Ed. 2013 (1945). In that case, the Supreme Court upheld the application of the antitrust laws to enjoin members of the Associated Press from a concerted refusal to deal with non-members of the organization. In addressing the First Amendment implications of the decision, the Supreme Court declined to apply any heightened form of scrutiny to the application of the antitrust statutes, despite the fact that the decision compelled the members of the Associated Press to share access to their news stories and thus, arguably, to "speak"

in a manner contrary to their wishes. *Id.* at 19-20, 65 S.Ct. at 1424-25.

Associated Press stands only for the proposition, confirmed in numerous other decisions, that the media may be subjected to economic regulations that are generally applicable to all industries without triggering heightened review of such regulations under the First Amendment. *See, e.g., Oklahoma Press Publishing Co. v. Walling*, 327 U.S. 186, 192-93, 66 S.Ct. 494, 497, 90 L.Ed. 614 (1946) (application of Fair Labor Standards Act); *Associated Press v. NLRB*, 301 U.S. 103, 132-33, 57 S.Ct. 650, 655-56, 81 L.Ed. 953 (1937) (application of National Labor Relations Act). The Supreme Court has made clear, however, that this line of cases does not mean that economic regulation is subject only to rationality review regardless of the degree to which the regulation impinges on an entity's First Amendment activity. To the contrary, *O'Brien* and its progeny have plainly held that heightened scrutiny will be applied to those governmental actions that have a significant, disproportionate, impact on expressive conduct, even if such impact is only an incidental effect of the statute. *See, e.g., Minneapolis Star & Tribune Co. v. Minnesota Commissioner of Revenue*, 460 U.S. 575, 585, 103 S.Ct. 1365, 1371-72, 75 L.Ed.2d 295 (1983) ("differential treatment . . . of the press" implicates the First Amendment and is "presumptively unconstitutional").

Section 533(b) is not a generally applicable statute; it applies to a sharply limited number of entities—companies providing local telephone exchange services. Moreover, § 533(b) achieves its aim by means of a direct abridgement of the telephone companies' right to participate in a protected form of speech. This is centrally significant, for the Supreme Court has never accorded mere rationality review to a statute, even a "structural" economic regulation, that, on its face, prohibited a specific category of speakers from engaging in a pro-

tected form of speech. *C.f. Arcara*, 478 U.S. at 697, 106 S.Ct. at 3172 (refusing to apply heightened First Amendment review to statute that incidentally burdened First Amendment rights but was not expressly "directed" at communicative activity). In light of *O'Brien* and its progeny, § 533(b) must plainly be evaluated on a standard higher than mere "rationality" review.

B.

At first glance, it would appear virtually certain that a statute restricting telephone companies from providing video programming to customers within their service areas would fall within one of the two content-neutral categories, either as: (1) a time, place, and manner restriction on the form of the telephone companies' speech [19] or (2) an economic regulation directed at non-speech conduct, but inflicting a substantial, and disproportionate, incidental effect on the telephone companies' right to engage in expressive activity. After all, had Congress chosen to prohibit telephone companies from transmitting any visual

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[19] Plaintiffs argue that § 533(b) cannot properly be viewed as a "time, place, or manner restriction" because the statute precludes them entirely from reaching a specific audience by use of a specific means of communication. This argument has no merit. Plaintiffs greatly overstate the blanketing effect of the restriction placed upon them. Plaintiffs may provide video programming to audiences outside their service area, and may speak through any type of non-video medium to audiences inside their service area. Even more significantly, however, plaintiffs may also reach audiences within their service area with video programming. Section 533(b) only prohibits plaintiffs from *directly* providing video programming to their subscribers. Plaintiffs are not prohibited from producing their own video programming and marketing it to broadcasters or cable operators for transmission by means other than the plaintiffs' own facilities. Public access requirements ensure that such programming cannot be silenced by the entities responsible for the direct provision of video programming. Clearly, then, § 533(b) operates only as a restriction on the "manner" in which plaintiffs may speak, not as an outright ban on their ability to do so.

image, the resulting statute would almost certainly be content-neutral, and there would be no persuasive argument that such a statute would be subject to strict scrutiny.[20] Yet, analysis cannot end here for § 533(b), as

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[20] The Court rejects plaintiffs' contention that § 533(b) should be subjected to strict scrutiny solely because it singles out a particular class of speaker, the telephone companies and their affiliates, for unfavorable treatment. Strict scrutiny is not applicable to a statute which targets a particular class of speaker, provided that class is sufficiently large, unless the statute also discriminates based on the content of the speech. *See Leathers*, 499 U.S. at ——, 111 S.Ct. at 1446 ("a differential burden on speakers is insufficient by itself to raise First Amendment concerns"); *Turner Broadcasting System, Inc. v. FCC*, 819 F.Supp. 32, 42 (D.D.C.1993) (" 'Speaker-partial' regulations, or those that purportedly favor one group of speakers at the expense of others . . . are not subject to strict scrutiny unless they are content-based."), *appeal pending*. To the extent that the Fourth Circuit's opinion in *Henrico Professional Firefighters Association v. Board of Supervisors*, 649 F.2d 237 (4th Cir.1981), can be read to hold that speaker-partiality alone is sufficient to trigger strict scrutiny, that aspect of the opinion has been implicitly overruled by the Supreme Court's decision in *Leathers*.

The Court also rejects plaintiffs' argument that, based on the Supreme Court's decisions in *Schneider v. State*, 308 U.S. 147, 60 S.Ct. 146, 84 L.Ed. 155 (1939) and *Martin v. Struthers*, 319 U.S. 141, 63 S.Ct. 862, 87 L.Ed 1313 (1943), there is a separate, and heightened, standard of review applicable when the government seeks to "eliminate an entire category or manner of speech, even on the basis of a content-neutral restriction. . . ." Plaintiffs' Reply Br. at 40. The *Schneider* and *Martin* decisions are best read, not as inaugurating a conceptually separate, and still viable, standard of review, but rather, as foreshadowing the Supreme Court's modern "time, place, and manner" doctrine. Specifically, these cases stand for the proposition, made explicit in cases such as *Ward*, 491 U.S. at 789, 109 S.Ct. at 2753, and *Clark*, 468 U.S. at 293, 104 S.Ct. at 3069, that a "time, place, and manner" restriction will not survive the *O'Brien* test unless the statute preserves ample effective alternative channels for communication. *See Martin*, 319 U.S. at 146, 63 S.Ct. at 865 ("Door to door distribution of circulars is essential to the poorly financed causes of little people."); *Schneider*, 308 U.S. at 164, 60 S.Ct. at 152 ("[P]amphlets have proved most effective instruments in the dissemination of opinion. . . . [Interference with] the free and unhampered distribution of

written and enacted, requires reference to the content of the relevant message in order to determine whether a particular visual image qualifies under the statutory definition of "video programming." This circumstance substantially complicates the analysis concerning whether § 533(b) is a content-based or content-neutral regulation.

The 1984 Cable Act defines "video programming" as "programming provided by, or generally considered comparable to programming provided by, a television broadcast station." 47 U.S.C. § 522(19). The parties do not dispute that § 533(b) permits the telephone companies to transmit visual images such as the face of a clock reflecting the current time, or the image of a person speaking to the viewer by picture-phone. Such images are permissible under the statute because they are not comparable to programming that was provided by a television broadcast station in 1984.[21] A moment's reflection makes it readily apparent that the cognitive process necessary to apply the video programming definition cannot be accomplished without comparing the content of the image being tested with the content of 1984 broadcast television programming. Despite defendants' protestations to the contrary, there is simply no way that § 533(b), incorporating as it does the § 522(19) definition, can be applied

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pamphlets strikes at the very heart of the constitutional guarantees.").

[21] The Commission has ruled that the standard is not an evolving one, dependent on the innovations in broadcast television programming, but rather that the standard must be interpreted with reference to the content of broadcast television at the time of the passage of the statute. *See* Video Dialtone Order, 7 FCC Rcd. at 5820. The parties have not challenged this interpretation, nor suggested any reason why the interpretation is unreasonable, so the Court defers to the Commission's interpretation in accordance with the principle set forth in *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844, 104 S.Ct. 2778, 2782, 81 L.Ed.2d 694 (1984).

without reference to the content of the message being conveyed.[22]

The line between permissible visual images and impermissible "video programming" has become increasingly blurred with the advance of technology. This is nowhere more evident than in the Commission's most recent interpretation regarding the scope of the § 533(b) ban, the Video Dialtone Order. *See* 7 FCC Rcd. at 5781. In that action, the Commission modified its rules to allow telephone companies to provide a package of video services know as "video dialtone." The Commission found that its action did not violate § 533(b) because the video services included within the video dialtone package did not meet the statutory definition of "video programming." In "clarifying" its interpretation of the scope of § 533 (b), the Commission presented the following example:

> We . . . conclude that programming that includes multimedia graphics and information services that incorporate video images generally would not be

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[22] Illustrative of this point is the following colloquy between the Court and government counsel at the hearing on the cross-motions for summary judgment:

> THE COURT: Let's suppose it [the statute] says telephone companies can't send television programming, but they can send [The McNeil/Lehrer Newshour]. Would that be constitutional?
>
> MS. WILSON: No, it would not be constitutional. . . .
>
> THE COURT: Well, let me go on. . . . Let's suppose then it says . . . you may not send the news programs and you may not send sitcoms. That wouldn't pass muster either, would it?
>
> MS. WILSON: That's right.
>
> THE COURT: And I guess you can see I can give you a list of what's on television in 1984. . . . If you got out the T.V. Guide for 1984 you could end up with a generic list of all the stuff that's on television. And, why wouldn't that then also not pass muster? . . . What's the difference [between that and the statutory definition of "video programming"]?

Tr. at 45-47.

> video programming because the video images are not severable from the program service. . . . For instance, an educational multimedia presentation which may contain video images would be permissible under our interpretation. . . . We do not contemplate, however, that the simple inclusion of some textual information, for example, could transform a severable video program into a permissible multimedia program.

Video Dialtone Order, 7 FCC Rcd. at 5822 & n. 196. Fortunately, the Court is not called upon to interpret or apply this language. Apparently, the Commission will allow telephone companies to transmit presentations that are primarily textual, and include some video segments, but will prohibit presentations that are primarily video, and include some textual segments. Irrespective of whether this is a workable line of demarcation, the example is noteworthy because it shows that the Commission's interpretation is inescapably premised on the content of the relevant transmission.[23]

Notwithstanding the fact that application of § 533(b) depends on the content of the telephone companies' proposed message, the section cannot, under recent Supreme

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[23] Contrary to defendants' assertions, the present case is clearly distinguishable from *Regan v. Time, Inc.*, 468 U.S. 641, 104 S.Ct. 3262, 82 L.Ed.2d 487 (1984), in which the Supreme Court found content-neutral a federal statute requiring all reproductions of United States currency to be in black and white and to be smaller than three-fourths or larger than one and one-half the size of the original. In that case, the Supreme Court found that "the Government does not need to evaluate the nature of the message being imparted in order to enforce the color and size limitations." *Id.* at 656, 104 S.Ct. at 3271. This case is different; application of § 533(b) does not involve a simple comparison of sizes or colors. Even if the FCC purported to propound a precise line of demarcation (*i.e.* over 50% "video programming" would bring a multimedia presentation within the scope of the statute), determination of which images were video and which were not would still inescapably involve content-based judgments.

Court precedent, be considered a content-based restriction. Recent decisions have made clear that "strict scrutiny" is not triggered because *application* of a speech restriction is dependent on the content of the speech. Rather, "[g]overnment regulation of expressive activity is content-neutral [and therefore not subject to strict scrutiny] so long as it is '*justified* without reference to the content of the regulated speech.'" *Ward*, 491 U.S. at 791, 109 S.Ct. at 2754 (quoting *Community for Creative Non-Violence*, 468 U.S. at 293, 104 S.Ct. at 3069) (emphasis added by the *Ward* opinion). "The government's purpose is the controlling consideration." *Ward*, 491 U.S. at 791, 109 S.Ct. at 2754.

The import of this distinction was made apparent in *Renton v. Playtime Theatres, Inc.*, 475 U.S. 41, 106 S.Ct. 925, 89 L.Ed.2d 29 (1986), in which the Supreme Court was faced with a municipal ordinance imposing zoning limitations on the location of "adult theaters." The applicability of the ordinance in that case to any specific theater clearly turned on an evaluation of the content of the films exhibited at that theater. Nevertheless, the Court refused to apply strict scrutiny to the ordinance, holding that the ordinance had been *justified* as a means of preventing various "secondary effects" of adult theaters, such as crime, devaluation of adjacent properties, and alienation of retail establishments, and that such justification was "unrelated to the suppression of free expression." *Id.* 475 U.S. at 48, 106 S.Ct. at 929.

Similarly, the government in this case has advanced two justifications for the § 533(b) ban that are unrelated to the suppression of free expression: (1) protecting diversity of ownership of communications outlets and (2) promoting competition in the video programming market. Thus, in this case, as in *Renton*, a speech restriction that makes a facial distinction based on content is justified by the government on the basis of certain secondary effects of that speech. Here, as in *Renton*, the government admittedly seeks to restrict speech, on the ground

that the prevention of these secondary effects will be advanced by the restriction. If applied here, *Renton* would allow § 533 to escape strict scrutiny and to be subject instead to the less rigorous "intermediate" level of scrutiny prescribed by *O'Brien*. Before proceeding with the analysis, an important objection to *Renton* must be addressed.

Renton signals a significant retreat from the traditional content-based/content-neutral distinction. The notion that a legislative act curtailing First Amendment rights is to be evaluated based on its justification rather than on its operation is more than a little troubling. The theoretical underpinning of the content-based/content-neutral distinction in First Amendment jurisprudence has been an awareness that content-based restrictions, whatever their ostensible justifications, afford legislatures increased opportunities to elevate one viewpoint over another. *See* Geoffrey R. Stone, *Content-Neutral Restrictions*, 54 U. Chi.L.Rev. 46 (1987). Moreover, the distinction is grounded in the notion that courts cannot consistently recognize when a content-based restriction will have the effect of fostering or penalizing a particular viewpoint, or when the legislature's asserted "secondary effect" justification is disingenuous.[24] Thus, any speech restriction, the application of which depends on the message's content, has traditionally, and appropriately, been treated with suspicion by the courts as a potential vehicle for the conscious or unconscious prejudices of the legislature. *See Boos v. Barry*, 485 U.S. 312, 336-37, 108 S.Ct. 1157, 1171-72, 99 L.Ed.2d 333 (1988) (Brennan, J.

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[24] *See Burson v. Freeman*, —— U.S. ——, ——-——, 112 S.Ct. 1846, 1858-59, 119 L.Ed.2d (1992) (Kennedy, J. concurring) ("Discerning the justification for a restriction of expression, however, is not always . . . straightforward. . . . In some cases, a censorial justification will not be apparent from the face of a regulation which draws distinctions based on content, and the government will tender a plausible justification unrelated to the suppression of speech or ideas.").

concurring in the judgment) ("[T]he best protection against governmental attempts to squelch opposition has never lain in our ability to assess the purity of legislative motive but rather in the requirement that the government act through content-neutral means that restrict expression that government favors as well as expression it disfavors.").

The Supreme Court's recent reliance, in cases such as *Renton*, on a legislature's justification of a statute, rather than on the means by which the statute achieves its ends, preserves the form of the content-neutral/content-based distinction, but guts it of its potency. The *Renton* "secondary effects" doctrine abandons the healthy mistrust of the judiciary's ability to detect viewpoint distorting effects of content-based regulations in favor of a misplaced confidence that either: (a) legislatures will always acknowledge any viewpoint distortion likely to result from a regulation or (b) courts will consistently be able to predict which content-based regulations will be devoid of distorting effects. This approach is not likely to be adequately protective of First Amendment values. *See id.* 485 U.S. at 336, 108 S.Ct. at 1172 ("[T]he inherently ill-defined nature of the *Renton* analysis certainly exacerbates the risk that many laws designed to suppress disfavored speech will go undetected.").

Renton remains the only case to date in which a majority of the Supreme Court has found that the government's asserted content-neutral justification for a statute can overcome the fact that the statute, on its face, has drawn a content-based distinction. This lends some force to the plaintiffs' contention that *Renton* should be viewed as an isolated decision, applicable only in the context of sexually explicit speech.

The problem with this argument is that the Supreme Court, just last term, had an opportunity to limit *Renton* in such a fashion, and refused to do so. In *City of Cincinnati v. Discovery Networks, Inc.*, —— U.S. ——, 113

S.Ct. 1505, 123 L.Ed.2d 99 (1993), the Court was faced with a municipal ordinance that banned newsracks purveying commercial publications from being placed on public property. In *Discovery Network*, as in *Renton* and the present case, the applicability of the relevant ordinance turned on a content-based distinction—in that case, between commercial and non-commercial publications. Cincinnati attempted to rationalize its ordinance as in *Renton* and the present case, with content-neutral justifications—in that case, safety and aesthetics. In striking down the ordinance, the Supreme Court distinguished *Renton* by stating, "In contrast to the speech at issue in *Renton*, there are no secondary effects attributable to respondent publishers' newsracks that distinguish them from the newsracks Cincinnati permits to remain on its sidewalks." *Discovery Network*, —— U.S. at ——, 113 S.Ct. at 1517. Another section of the majority's opinion states, "[W]e do not reach the question whether, given certain facts and under certain circumstances, a community might be able to justify differential treatment of commercial and noncommercial newsracks. We simply hold that on this record Cincinnati has failed to make such a showing." *Id.* —— U.S. at ——, 113 S.Ct. at 1516. Thus, the opinion invites the inference that, had the city placed in the record some showing of differing effects attributable to the commercial newsracks, *i.e.* that people were more prone to litter with the commercial publications or that the commercial newsracks were bigger, flashier, or in some way a greater eyesore, then the *Renton* analysis would have been applicable and the ordinance might have been upheld. *Discovery Network* is significant, therefore, as an indication that the Court does not view *Renton* as an aberrant decision or the "secondary effects" theory as a limited principle, applicable only to sexually explicit speech. *See also Boos*, 485 U.S. at 312, 108 S.Ct. at 1157-58 (plurality of justices indicate willingness to apply *Renton* analysis to political speech). This apparent general applicability of *Renton* compels the holding here that § 533(b) is a content-neutral re-

striction, despite the fact that the determination of whether the statute applies to any particular message may only be accomplished by reference to the content of that message. The two interests advanced by the government in support of § 533(b), diversity in the ownership of communications outlets and competition in the video programming market, are, in the same sense as the secondary effects in *Renton*, justifications which are made "without reference to the content of the regulated speech." *Ward*, 491 U.S. 781, 782, 109 S.Ct. 2746, 2748.

While plaintiffs argue that the statute achieves its ends only by the suppression of speech, and thus that the asserted "secondary effects" justification is itself impermissible, *see Buckley*, 424 U.S. at 48-49, 96 S.Ct. at 648-49 (government may not "restrict the speech of some elements of our society in order to enhance the relative voice of others"), this argument is, on closer scrutiny, tautological. *Renton* only applies to statutes that restrict speech. Thus any statute analyzed under the *Renton*-type analysis will necessarily achieve its goal of regulating "secondary effects" by means of the suppression of speech. To invalidate a statute simply because the regulation of "secondary effects" is achieved by restricting speech would lead to the result that every statute analyzed under *Renton* would invariably be struck down. *Renton* itself proves that is not the law.

For the foregoing reasons, it follows that, while § 533(b) must be subjected to heightened review as a restriction on plaintiffs' First Amendment rights, it does not warrant the strictest standard of review reserved for content-based restrictions on speech. The fact that § 533(b) is "justified" on grounds unrelated to the suppression of the speech means, notwithstanding this Court's misgivings about the *Renton* reasoning, that the statute must be classified as content-neutral and subjected to the intermediate level of scrutiny first articulated in *O'Brien* and applicable to both "time, place, and manner restrictions" and to incidental burdens on speech.

IV.

Ward teaches that a statute will pass the intermediate level of scrutiny if, in addition to being content neutral, it: (1) is narrowly tailored to serve a significant government interest and (2) leaves open ample alternative channels for communication. *See Ward*, 491 U.S. at 789, 109 S.Ct. at 2753. With respect to § 533(b), there is little doubt that the statute leaves open ample alternative channels for communication. As discussed above, plaintiffs remain unfettered in their ability to communicate by any means other than video programming. Moreover, plaintiffs may directly provide video programming to anyone residing outside their area of service. Finally, plaintiffs may communicate with subscribers inside their service area through video programming by producing such programming and marketing it to broadcasters and cable operators. Plaintiffs are by no means "silenced" by the operation of § 533(b).

Given this, the Court must determine whether § 533(b) is "narrowly tailored to serve a significant governmental interest." As the history of § 533(b) makes clear, the rapidly changing nature of the telecommunications field has caused the rationale supporting the statute to evolve over time. Congress' precise intent in passing § 533(b) in 1984 is made difficult to discern both by the paucity of legislative materials and by the fact that Congress' sole expression of intent—to "codify current FCC rules"—occurred at a time when the Commission's rationale for its own rules was in a state of flux. *Compare* 1970 Order, 21 F.C.C.2d at 324 (stressing pole access concerns) *with* OPP Report at 153-65 (emphasizing threat of cross-subsidization). It is not necessary to the present inquiry, however, to parse the record of Commission proceedings and concomitant Congressional statements in order to determine precisely which of the Commission's concerns Congress was seeking to vindicate by passage of § 533(b). For purposes of applying the *O'Brien* test, a reviewing court "must eschew altogether the 'guesswork'

of speculating about the motives of lawmakers. . . . Rather, [the court] must look to the face of the regulation and the identifiable interests advanced to justify the regulation." *11126 Baltimore Blvd. v. Prince George's County*, 886 F.2d 1415, 1426 (4th Cir.1989), *vacated on other grounds*, 496 U.S. 901, 110 S.Ct. 2580, 110 L.Ed.2d 261 (1990); *see also Hart Book Stores, Inc. v. Edmisten*, 612 F.2d 821, 829 (4th Cir.1979), *cert. denied*, 447 U.S. 929, 100 S.Ct. 3028, 65 L.Ed.2d 1124 (1980). As such, § 533(b)'s evolving rationale is nonproblematical. Regardless of what rationale may have been offered for § 533(b) at the time of its passage, if, as conditions exist today, the government can assert a justification for the statute such that the statute is "narrowly tailored to serve a significant government interest," then the statute must be upheld.

The government contends that § 533(b) serves two separate, but related, interests: promoting competition in the video programming market and preserving diversity in the ownership of communications media. Upon reflection, however, these concerns can be seen to collapse into a single interest. Section 533(b) simply does not, in a direct fashion, promote competition in the video programming market. As the cable television industry currently exists in the United States, the transport of video programming is a monopoly service. *See* Joint Stipulation of Facts ¶ 28 ("Of the approximately 10,000 communities served by cable, as of 1991, 53 communities had more than one competing cable system in the same locality."). Section 533(b), which serves to bar entry into the market for video transport service by the one class of potential competitors that has exhibited an inclination to compete with the entrenched monopolists, clearly operates in the first instance to restrict competition in the market for video programming by limiting the number of outlets through which such programming can be distributed. Thus, on the most elemental level, § 533(b) actually reduces competition, both in the mar-

ket for video transport services and the market for video programming.

It is only by concentrating on the government's other asserted justification, protecting diversity of ownership of communications outlets, that any pro-competitive consequenses of § 533(b) can be discerned. In essence, the government contends that the telephone companies would be *too* successful if they were allowed to compete in the cable television market. According to the government, without a prophylactic rule keeping them out of the industry altogether, the telephone companies would face irresistible incentives to undertake anti-competitive actions to drive the cable operators out of business. If the telephone companies were allowed to succeed, the resulting situation would be worse for consumers than the *status quo* because rather than having two monopolists—one providing cable television and related services and one providing local telephone exchange service and related services—consumers would be faced with a single monopolist, the telephone company, providing all of their telecommunication services. In addition to its desire to preserve the economic benefit of competition between the monopolists for the provision of services outside their "core" monopoly service, the government is also justifiably concerned with the implications of having a single entity in control of *all* electronic communication sources entering an individual's home. Thus, the government asserts, to preserve diversity of ownership of communications outlets, telephone companies must be prevented from entry into the cable television industry.[25] Without question, the

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[25] The government has identified two potential anti-competitive practices that the telephone companies would allegedly have incentive to undertake in the absence of the § 533(b) ban: (1) discrimination in the provision of access to telephone poles and (2) cross-subsidization. It is important to note that the practice of cross-subsidization would have significant negative consequences, such as higher costs to local telephone service ratepayers and misallocation of telephone company resources, regardless of whether

preservation of diversity of ownership of communications outlets is a significant governmental interest. *See NCCB*, 436 U.S. at 801-02, 98 S.Ct. at 2115-16 (challenged regulations "are a reasonable means of promoting the public interest in diversified mass communications"); *National Association of Broadcasters v. FCC*, 740 F.2d 1190, 1206 (D.C.Cir.1984) ("Traditionally, the FCC has considered diversification of media ownership to be an important objective of federal communications regulatory policy."). Thus, the sole remaining question under the *O'Brien* test is whether § 533(b) is narrowly tailored to serve that interest.

As the *Ward* decision makes clear, in the context of intermediate review under *O'Brien*, the remedy chosen by Congress "need not be the least-restrictive or least-intrusive means" of achieving Congress' goal. 491 U.S. at 796-99, 109 S.Ct. at 2757-58. "Rather, the requirement of narrow tailoring is satisfied 'so long as the . . . regulation promotes a substantial government interest that would be achieved less effectively absent the regulation.'" *Id.* 491 U.S. at 799, 109 S.Ct. at 2758 (quoting *United States v. Albertini*, 472 U.S. 675, 689, 105 S.Ct. 2897, 2906-07, 86 L.Ed.2d 536 (1985)). The regulation in question may not, however, "burden substantially more speech than is necessary to further the government's legitimate interests." *Id.* As the Court explained in *Discovery Network*:

> A regulation need not be "absolutely the least severe that will achieve the desired end," but if there are numerous and obvious less-burdensome alternatives to the restriction . . . that is certainly a relevant con-

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the telephone companies were able to amass sufficient market power to become monopolists in the video transmission market. Thus, the evil targeted by § 533(b) is not limited to the end result of the telephone companies' predicted anti-competitive practices, but includes also the negative consequences arising from the *process* of attempted monopolization.

> sideration in determining whether the "fit" between ends and means is reasonable.

—— U.S. at —— n. 13, 113 S.Ct. at 1510 n. 13 (quoting *Board of Trustees of State University of New York v. Fox*, 492 U.S. 469, 480, 109 S.Ct. 3028, 3034-35, 106 L.Ed.2d 388 (1989)) (internal citation omitted).[26]

There is no more draconian approach to solving the problem of potential anti-competitive practices by telephone companies in the cable television industry than a complete bar on their entry into that industry. In theory, at least, there are a wide range of less restrictive alternatives that Congress and the Commission could have chosen to pursue that would have allowed telephone companies to enter the cable television market, while constraining, through specific legislation or regulatory scrutiny, their power to drive other cable operators out of the industry. If a number of such alternatives are found to be effective means of eliminating the threats at which § 533(b) is targeted, then the statute certainly is not "narrowly tailored." In short, if there exists a range of regulatory strategies that would effectively eliminate the threat of anti-competitive conduct by the telephone companies in the cable television industry, then § 533(b) would

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[26] While the language in *Discovery Network* is addressed to the "reasonable fit" requirement applicable to regulation of commercial speech, not the "narrowly tailored" requirement in *Ward*, the Supreme Court has previously noted the essential equivalence of these two formulations. *See Fox*, 492 U.S. at 475-80, 109 S.Ct. at 3032-35. There is no reason to doubt that the language in *Discovery Network* would be equally applicable to the "narrowly tailored" requirement. *See Arlington County Republican Committee v. Arlington County*, 983 F.2d 587, 594 (4th Cir.1993) (existence of less restrictive means is relevant consideration concerning whether statute is narrowly tailored); *see also Ward*, 491 U.S. at 806, 109 S.Ct. at 2762 (Marshall, J. dissenting) ("If a court cannot engage in [inquiries regarding less restrictive means], I am at a loss to understand how a court can ascertain whether the government has adopted a regulation that burdens substantially more speech than is necessary.").

"burden substantially more speech than is necessary to further the government's legitimate interests," and would therefore violate the First Amendment.

It is important to note that, in inquiring into the existence of feasible less restrictive alternatives, courts must not substitute their judgment on policy matters for that of Congress. *C.f. Community for Creative Non-Violence*, 468 U.S. at 299, 104 S.Ct. at 3072 (reversing Court of Appeals for disagreeing with Park Service over existence of less speech-restrictive alternatives). Certainly, any findings of fact made by Congress concerning the potential effectiveness of Commission regulation of the pole access and cross-subsidization problems would be entitled to substantial deference from the courts. *See Columbia Broadcasting System, Inc. v. Democratic National Committee*, 412 U.S. 94, 103, 93 S.Ct. 2080, 2087, 36 L.Ed.2d 772 (1973).[27] Yet, nowhere in the legislative materials is there any indication that Congress reached a conclusion concerning the effectiveness of less restrictive regulatory measures to combat the potential for anti-competitive practices by the telephone companies in the cable television market. Committee findings are limited to expressions of opinion on the effectiveness of § 533(b), not on the effectiveness of any less restrictive alternatives. Thus, a House Committee Report indicated that § 533(b) would "encourage a diversity of ownership of communications outlets" (H.R.Rep. 934, 98th Cong., 2d Sess. 56 (1984) U.S. Code Cong. & Admin.News 1984, p. 4693), and a more recent Senate Committee Report opined that the § 533(b) ban "enhance[s] competition" (S.Rep. No. 92, 102d Cong., 1st Sess. 18 (1991) U.S. Code Cong. & Admin.News 1992, p. 1150). Yet, no Congressional find-

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[27] Although, obviously, "whatever deference is due legislative findings would not foreclose [the court's] independent judgment of the facts bearing on an issue of constitutional law. . . ." *Sable Communications of California, Inc. v. FCC*, 492 U.S. 115, 129, 109 S.Ct. 2829, 2838, 106 L.E.2d 93 (1989).

ing has ever been made concerning whether these goals could be accomplished by means of a less intrusive measure than a complete prophylactic ban.

Defendants contend, in light of the extensive Congressional attention devoted to this issue,[28] that it is appropriate to impute to Congress a finding that all less restrictive alternatives were infeasible. The Court declines this invitation. It cannot be law that, whenever Congress passes a statute infringing on the right to free expression, it will be inferred by reviewing courts that Congress considered and rejected the effectiveness of all less restrictive alternatives. Such a proposition would reduce the "narrowly tailored" prong of the *O'Brien* test to a nullity. Rather, this court must undertake its own review of the record to determine whether Congress "reasonably *could have*" found that a prophylactic ban was necessary to effectively accomplish Congress' purposes. *See San Francisco Arts & Athletics, Inc. v. United States Olympic Committee,* 483 U.S. 522, 539, 107 S.Ct. 2971, 2982, 97 L.Ed.2d 427 (1987) (emphasis added).

In assessing whether § 533(b) is indeed necessary, it is essential to carefully examine precisely what the statute prevents. Section 533(b) prohibits a telephone company from directly providing video programming to subscribers in its service area. Significantly, the statute has not been interpreted to prohibit a local telephone company from providing video transport services. Thus, a telephone company is permitted to run a cable into a subscriber's home and then to lease channels of communications on that cable to unaffiliated entities, such as cable operators. *See* Joint Stipulation of Facts, ¶¶ 5, 74; *see also* Video Dialtone Order, 7 FCC Rcd. at 5787 & n. 21. The telephone company only runs afoul of the statute by exercising control or discretion over the programming transported over its facilities.

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[28] *See* n. 9 & n. 10, and accompanying text, *supra.*

The fact that telephone companies are not precluded under existing law from competing in the market for video transport services is of paramount significance to the outcome of this case. The government's asserted justification for § 533(b), preservation of diversity in the ownership of media outlets, is premised on the fear that telephone companies will engage in pole access discrimination and cross-subsidization in an attempt to monopolize the video transport market. Surprisingly, however, § 533(b) is irrelevant to the telephone companies' ability to undertake such practices. Put another way, the ban imposed by § 533(b) does not fit with its asserted justification.[29]

Defendants attempt to finesse the mismatch between the effect of § 533(b) and its asserted justification by submitting an affidavit by Bruce M. Owen, former Chief Economist of the Antitrust Division of the United States Department of Justice. In his affidavit, Owen concedes that the telephone companies are already in a position to cross-subsidize video transmission service. But he goes on to argue that:

> telephone companies' incentive to engage in that cross-subsidization is greatly enhanced if telephone companies are also allowed to exploit monopoly control of video transmission by earning excess profits in video programming. Simply put, the removal of

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[29] Defendants have advanced the cross-subsidy argument with greater vigor than the pole access argument. This is understandable, for there is substantial disagreement in the record concerning the potential effectiveness of regulatory controls on cross-subsidization, but there is no doubt that, to the extent that the existing Pole Attachment Act does not entirely prevent the possibility of pole access discrimination, effective legislation could be passed to guarantee non-discriminatory access. If discriminatory pole access were the sole concern of Congress in enacting a prophylactic ban on a telephone company's ability to speak through video programming, then such a ban would plainly burden more speech than necessary to further the government's interests.

§ 533(b) would make a video transmission monopoly more valuable to a telephone company.

Reply Affidavit of Bruce M. Owen at 2-3.[30] As is apparent from Owen's affidavit, it is the concern that telephone companies will act anti-competitively in the *video programming* market, not the *video transport* market, that ultimately must provide the justification for § 533(b). Yet all the evidence adduced regarding the difficulty of regulating anti-competitive conduct of the telephone companies relates to difficulties in monitoring their conduct in the video transport business.[31] There is no contention that the telephone companies possess any inherent advantage that would allow them successfully to evade regulation of anti-competitive behavior in the video programming market.[32] Even under the government's worst case scenario,

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[30] *See also* FNOI, 3 FCC Rcd. at 5864 ("Barring carriers from providing video programming in the service areas in which they also control the local exchange networks and facilities on which the delivery of cable programming provided by third parties generally depends surely reduces carrier incentive and ability to engage in anti-competitive conduct in those service areas.").

[31] *See, e.g.*, Owen Affidavit at 15 ("Local telephone companies have a substantial opportunity to engage in cross-subsidization when, as here, both the competitive video transmission service and the monopoly service are provided on common facilities with common costs. . . . Common costs mean that cross-subsidization is virtually impossible to detect and eliminate. It is the existence of significant common costs which differentiates telephone companies from [other potentially anti-competitive actors]."); OPP Report at 157 ("One of the most difficult aspects of telephone regulation is the assignment of costs to their causes. Cable and telephone systems share a certain amount of capital equipment; allocating shared costs between these capital accounts on the basis of actual costs causation will be difficult or impossible.") (footnotes omitted).

[32] *See* Reply Affidavit of Alfred E. Kahn, Professor Emeritus of Political Economy, Cornell University, at 3-4 ("It is difficult to conceive that there could be any substantial costs common to the transmission of video and other telephone signals, on the one side, and the creation and packaging of video programming on the

in which the telephone companies succeed in driving out all competition for the provision of video transport service, the telephone companies would be in no better position to act anti-competitively in the video programming market than are the current monopolists in the video transport market, the existing cable operators.

In fact, the potential for telephone companies to act anti-competitively in the video programming market can be reduced to a level significantly below the level of risk currently tolerated in relation to the cable operators. To the extent that the existing legislative and regulatory framework may be viewed as ineffective in curbing anti-competitive actions in the video programming market, more restrictive conditions may be placed on the provision of video programming by telephone companies. For example, the Commission's current recommendation to Congress for repeal of § 533(b) includes a requirement limiting the telephone company's direct provision of video programming to a specified percentage of the channel capacity made available by the company's video transport facilities. Video Dialtone Order, 7 FCC Rcd. at 5850. The balance of the channel capacity would be required to be leased on a common carrier basis, and the system would be required to have the capability to accommodate multiple video programmers. *Id.* Such restrictions would eliminate any possibility that a telephone company could extract monopoly profits from the video programming market (even if it succeeded in monopolizing the video transport market) by artificially restricting the aggregate quantity of video programming, thereby inflating the market share of the telephone company's programming affiliate. *See also* Communications Competitiveness and Infrastructure Modernization Act of 1991, S. 1200, H.R. 2546, 102d Cong., 1st Sess., § 653 (1991) (proposing

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other. . . . There is therefore no rational connection between the defendants' cross-subsidy argument and the ban against telephone companies providing video *programming*.").

repeal of § 533(b) and 25% capacity limit upon local telephone company provision of video programming).[33]

In sum, this Court need not determine whether the Commission is correct in its assertion that its "existing safeguards . . . are sufficient at this time to protect against cross-subsidization. . . ." Video Dialtone Order, 7 FCC Rcd. at 5828. The Court accepts, *arguendo*, the proposition that cross-subsidization is uncontrollable by means of regulatory oversight.[34] The essential point is that tele-

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[33] The variety of conceivable measures that would effectively eliminate the potential for a telephone company to exercise market power in the video programming market drives home the point that there is not merely "some imaginable alternative" to § 533(b) "that might be less burdensome on speech," but rather an entire range of effective alternatives that would burden substantially less speech than § 533(b). *Cf. United States v. Albertini*, 472 U.S. 675, 689, 105 S.Ct. 2897, 2906-07, 86 L.Ed.2d 536 (1985).

[34] A considerable portion of the voluminous record in this case is devoted to the issue of whether cross-subsidization could effectively be eliminated by the scrutiny of the responsible regulatory agencies. Developments such as the expanded use of "price cap" rate reglation of the telephone companies and the Commission's increasing experience in formulating and implementing separation safeguards, *see, e.g. In re Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards*, 7 FCC Rcd. 7571 (1991), indicate that the regulatory environment is vastly changed since Congress' enactment of the 1984 Cable Act, with the prospects for effective regulatory oversight significantly improved. Yet, the Court cannot, on this record, confidently conclude that changes in the methods of regulation have absolutely eliminated the risk of cross-subsidization. Even the Commission, in recommending the repeal of § 533(b), found, not that cross-subsidization has been rendered impossible, but rather that "any remaining risk of anticompetitive conduct by the local telephone companies is *outweighed* by the potential public interest benefits their entry would bring." Video Dialtone Order, 7 FCC Rcd. at 5849 (emphasis added). Fortunately, in the final analysis the Court need not reach the issue of the potential effectiveness of the regulatory measures, because of § 533(b)'s essential irrelevance with respect to the prevention of cross-subsidization or, in fact, to the prevention of any anti-competitive conduct in the video transport market.

phone companies may already, under existing law, compete in the video transport market, and if it were possible for them to reap supra-competitive profits in that market through cross-subsidization, the telephone companies could do so irrespective of § 533(b). The only argument defendants can advance to give relevance to § 533(b) as a deterrent of anti-competitive behavior is to contend that the prospect of additional supra-competitive profits from the video programming market may give the telephone companies the needed additional incentive to monopolize the video transport market. This argument fails because there is neither evidence in the record nor any convincing argument to suggest that standard methods of regulation would be ineffective to control anti-competitive activities by the telephone companies in the video programming market. Telephone companies enter the *video programming* market, unlike the *video transport* market, with no inherent advantage that would enable them to evade effective regulation. The federal agencies charged with enforcement of the antitrust laws stand ready to guard against anti-competitive behavior in the video programming market, just as in any other industry.

In light of the fact that effective alternatives exist that would allow telephone companies to enter the cable television market, yet prevent the evils allegedly targeted by § 533(b), the Court finds that § 533(b) is not "narrowly tailored to serve a significant governmental interest," but instead, that the statute "burden[s] substantially more speech than is necessary to further the government's legitimate interests." The statute therefore fails the test articulated by the Supreme Court in *United States v. O'Brien*.[35]

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[35] Obviously, if the Court's analysis regarding the appropriate standard of review is flawed, and § 533(b) is properly subject to strict scrutiny, then the provision would fail the "narrowly drawn" element of that test as well. *See Ward*, 491 U.S. at 798 n. 6, 109 S.Ct. at 2758 n. 6. Section 533(b) would also fail strict scrutiny for the independent reason that preservation of diversity in the

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For the foregoing reasons § 533(b) is facially unconstitutional as a violation of plaintiffs' First Amendment right to free expression.[36] An appropriate Order, enjoining enforcement of § 533(b), will issue.

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ownership of communications media is not a sufficiently "compelling state interest" to provide justification for a content-based restriction on speech. *C.f. Burson*, —— U.S. at ——-——, 112 S.Ct. at 1857-58 (state's interest in preserving the "fundamental right . . . to cast a ballot in an election free from the taint of intimidation and fraud" makes *Burson* "the rare case in which we have held that a law survives strict scrutiny").

[36] There is no materially significant fact specific to the provision of cable television in the City of Alexandria, which would serve to distinguish this case from any other projected application of § 533(b). Accordingly, the Court determines that § 533(b) "could never be applied in a valid manner," and thus that plaintiffs have properly brought a facial challenge to the statute. *See Members of City Council of City of Los Angeles v. Taxpayers for Vincent*, 466 U.S. 789, 796-801, 104 S.Ct. 2118, 2124-27, 80 L.Ed.2d 772 (1984). Obviously, plaintiffs' "as applied" challenge succeeds for the identical reasons.

APPENDIX C

Filed January 18, 1995

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 93-2340

CA-92-1751-A

CHESAPEAKE AND POTOMAC TELEPHONE COMPANY; BELL ATLANTIC VIDEO SERVICES COMPANY; BELL ATLANTIC CORPORATION; CHESAPEAKE & POTOMAC TELEPHONE COMPANY; C & P TELEPHONE COMPANY OF MARYLAND; THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF WEST VIRGINIA; THE DIAMOND STATE TELEPHONE COMPANY; THE BELL TELEPHONE COMPANY OF PENNSYLVANIA; NEW JERSEY BELL TELEPHONE COMPANY

Plaintiffs-Appellees

v.

UNITED STATES OF AMERICA; FEDERAL COMMUNICATIONS COMMISSION; JANET RENO, in her official capacity as Attorney General of the United States

Defendants-Appellants

and

THE NATIONAL CABLE TELEVISION ASSOCIATION, INCORPORATED

Defendant

CONSUMER FEDERATION OF AMERICA; VIRGINIA CITIZENS CONSUMER COUNCIL; NEWSPAPER ASSOCIATION OF AMERICA; VIRGINIA PRESS ASSOCIATION; COMPUTER & COMMUNICATIONS INDUSTRY ASSOCIATION; METS FANS

UNITED/VIRGINIA CONSUMERS FOR CABLE CHOICE, et al.; CITIZENS FOR A SOUND ECONOMY FOUNDATION; THE AMERICAN LEGISLATIVE EXCHANGE COUNCIL; THE COMPETITIVE ENTERPRISE INSTITUTE; THE UNITED STATES TELEPHONE ASSOCIATION; AMERITECH CORPORATION; BELLSOUTH CORPORATION, GTE SERVICE CORPORATION on behalf of its affiliated domestic operating companies; NYNEX CORPORATION; PACIFIC TELESIS GROUP; ROCHESTER TELEPHONE CORPORATION; SOUTHWESTERN BELL CORPORATION; U S WEST INCORPORATED; TELECOMMUNICATIONS INDUSTRY ASSOCIATION, FIBER OPTICS DIVISION

Amici Curiae

No. 93-2341

CA-92-1751-A

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA; BELL ATLANTIC CORPORATION; BELL ATLANTIC VIDEO SERVICES COMPANY; CHESAPEAKE AND POTOMAC TELEPHONE COMPANY; THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF MARYLAND; THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF WEST VIRGINIA; THE DIAMOND STATE TELEPHONE COMPANY; THE BELL TELEPHONE COMPANY OF PENNSYLVANIA; NEW JERSEY BELL TELEPHONE COMPANY

Plaintiffs-Appellees

v.

THE NATIONAL CABLE TELEVISION ASSOCIATION, INCORPORATED

Defendants-Appellants

and

UNITED STATES OF AMERICA; FEDERAL COMMUNICATIONS COMMISSION; JANET RENO, in her official capacity as Attorney General of the United States

Defendants

CONSUMER FEDERATION OF AMERICA, VIRGINIA CITIZENS CONSUMER COUNCIL; NEWSPAPER ASSOCIATION OF AMERICA; VIRGINIA PRESS ASSOCIATION; COMPUTER & COMMUNICATIONS INDUSTRY ASSOCIATION; METS FAN UNITED/VIRGINIA CONSUMERS FOR CABLE CHOICE, et al.; CITIZENS FOR A SOUND ECONOMY FOUNDATION; THE AMERICAN LEGISLATIVE EXCHANGE COUNCIL; THE COMPETITIVE ENTERPRISE INSTITUTE; THE UNITED STATES TELEPHONE ASSOCIATION; AMERITECH CORPORATION; BELLSOUTH CORPORATION; GTE SERVICE CORPORATION on behalf of its affiliated domestic operating companies; NYNEX CORPORATION; PACIFIC TELESIS GROUP; ROCHESTER TELEPHONE CORPORATION; SOUTHWESTERN BELL CORPORATION; U S WEST INCORPORATED; TELECOMMUNICATIONS INDUSTRY ASSOCIATION, FIBER OPTICS DIVISION

Amici Curiae

On Petition for Rehearing with
Suggestion for Rehearing In Banc

The governmental appellants' and National Cable Television Association's petitions for rehearing and suggestions for rehearing in banc were submitted to this Court. As no member of this Court or the panel requested a poll on the suggestions for rehearing in banc, and

As the panel considered the petitions for rehearing and is of the opinion that they should be denied,

IT IS ORDERED that the petitions for rehearing and suggestions for rehearing in banc are denied.

For the Court,

/s/ Bert M. Montague
Clerk

APPENDIX D

SUPREME COURT OF THE UNITED STATES
OFFICE OF THE CLERK
WASHINGTON, DC 20543-0001

WILLIAM K. SUTER
Clerk of the Court

Area Code 202
479-3011

March 24, 1995

Mr. H. Bartow Farr III
Farr & Taranto
2445 M Street, N.W.
Washington, DC 20037

Re: National Cable Television
Association, Incorporated
v. Chesapeake and Potomac Telephone
Company of Virginia, et al.
Application No. A-703

Dear Mr. Farr:

The application for an extension of time within which to file a petition for a writ of certioari in the above-entitled case has been presented to the Chief Justice, who on March 24, 1995, extended the time to and including May 18, 1995.

This letter has been sent to those designated on the attached notification list.

Sincerely,

WILLIAM K. SUTER
Clerk

By /s/ Troy D. Cahill
TROY D. CAHILL
Assistant Clerk

APPENDIX E

FCC 95-20

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

CC Docket No. 87-266

IN THE MATTER OF

TELEPHONE COMPANY-CABLE TELEVISION
Cross-Ownership Rules,
Sections 63.54-63.58

FOURTH FURTHER NOTICE OF PROPOSED RULEMAKING

Adopted: January 12, 1995
Released: January 20, 1995

Comment Date: March 6, 1995
Reply Comment Date: March 21, 1995

By the Commission: Commissioners Barrett, Ness, and Chong issuing separate statements.

* * * *

7. *Legal and Constitutional Issues*

a. *Waiver of the Cross-Ownership Ban*

42. Section 533(b)(4) of the Communications Act [85] provides that, upon a "showing of good cause," the Commission may waive the 1984 Cable Act's cross-ownership ban. Under Section 533(b)(4), a waiver "shall be granted by the Commission upon a finding that the issuance of such waiver is justified by the particular circumstances demonstrated by the petitioner, taking into

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[85] 47 U.S.C. § 533(b)(4).

account the policy of this subsection." [86] In *GTE California, Inc. v. FCC*, the United States Court of Appeals for the Ninth Circuit found moot a case in which the FCC had rescinded a waiver granted under Section 533(b)(4).[87] In the course of so holding, and in response to GTE's argument that the waiver should not have been rescinded because Section 533(b) is unconstitutional, the Ninth Circuit stated that "GTECA did not present the constitutional issue to the Commission at a point in this proceeding where it could have tried to obviate the constitutional question by granting discretionary relief, such as a permanent waiver." [88]

43. In *GTE California v. FCC*, the Ninth Circuit raises the question whether the Commission may establish conditions under which it will waive the telco-cable cross-ownership ban in order to obviate potential constitutional difficulties. For example, the Commission may decide to authorize any telephone company to provide video programming, whether or not it has obtained an injunction, if it complies with the safeguards we will establish in this proceeding. Our tentative conclusion is that such a reading of Section 533(b)(4) is consistent with the terms of the statute. "Good cause" is commonly interpreted to include changed circumstances, and the circumstances that led us to institute the cross-ownership rule in 1970 have changed dramatically. The cable industry is no longer a fledgling industry. Instead, as the Supreme Court recently recognized, "Congress found that over 60 percent of the households with television sets subscribe to cable . . . and for those households cable has replaced over-the-air broadcast television as the primary provider of video programming." [89]

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[86] *Id.*

[87] *See GTE California v. FCC*, 39 F.3d at 942.

[88] *Id.* at 946.

[89] *Turner Broadcasting System, Inc. v. FCC*, 114 S. Ct. 2445, 2454 (1994).

44. We also tentatively conclude that the safeguards we will establish will constitute "particular circumstances . . ., taking into account the policy" of Section 533(b), under which waivers are warranted. We do not intend to waive the telco-cable cross-ownership rule altogether, so that telephone companies may purchase cable companies that do not face competition and offer their own programming via a monopoly cable system. Rather, and in fulfillment of the policy underlying Section 533(b), we intend to promote competition in the multi-channel video programming market by establishing particular conditions under which telephone companies may establish video dialtone systems that will compete with existing cable operators, thus providing consumers with a choice of multi-channel video systems.

45. The United States Court of Appeals for the District of Columbia Circuit recognized, in *NCTA v. FCC (1990)*, that "the policy of this subsection is to promote competition."[90] However, in that decision the D.C. Circuit also appeared to give a narrow reading to the scope of the waiver provision. Specifically, the court of appeals remanded a decision in which the Commission had granted a waiver because the court concluded that the Commission had not shown that the participation of an affiliate of a telephone company in constructing transmission facilities was "essential to the success" of an experimental video programming project.[91] But at that time no court had declared Section 533(b) unconstitutional, and the D.C. Circuit did not consider whether a broader reading of Section 533(b)(4) was appropriate to render the provision constitutional. The Supreme Court has recently reiterated that "a statute is to be construed where fairly possible so as to avoid substantial constitutional questions."[92] A reading of the waiver provision that au-

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[90] *NCTA v. FCC (1990)*, 914 F.2d at 287.

[91] *Id.* at 289.

[92] *United States v. X-Citement Video, Inc.*, 115 S. Ct. 464, 467 (1994) (*U.S. v. X-Citement Video*).

thorizes telephone companies that comply with the safeguards we will establish to provide video programming should render Section 533(b) constitutional, because in those circumstances any burden on speech by telephone companies will be minimal. Hence, under *U.S. v. X-Citement Video*, a broad interpretation of Section 533 (b)(4) seems warranted. We seek comment on these tentative conclusions.

b. *Constitutionality of Proposed Safeguards*

46. As the Court of Appeals for the Fourth Circuit stated in *C&P Tel. Co. v. U.S.*, in order for a content-neutral government regulation of speech, such as the cross-ownership ban, to be constitutional, that regulation must be "narrowly tailored to serve a significant governmental interest, and . . . leave open ample alternative channels for communication of the information."[93] The court determined that the government's interests in promoting competition and in facilitating the availability of multiple information sources are significant. The court decided, however, that the ban against telephone companies operating as cable service providers was not narrowly tailored and that there were available less burdensome alternatives to the ban.[94] The court observed that the Commission had already identified one possible alternative in its recommendation to Congress regarding repeal of the ban: Congress could limit the telephone company to a fixed percentage of available channels, while requiring the remainder of channels to be made available to others on a common carrier basis.[95] Finally,

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[93] *C&P Tel. Co. v. U.S.* slip op. at 31 (citing *Ward v. Rock Against Racism*, 491 U.S. 781, 791 (1989) (quoting *Clark v. Community for Creative Non-Violence*, 468 U.S. 288, 293 (1984))).

[94] *C&P Tel. Co. v. U.S.* slip op. at 38.

[95] *Id.* at 38-39 & n.34 (citing *Video Dialtone Reconsideration Order*). While the court discussed the availability of options less burdensome than the cross-ownership ban, it did not address the constitutionality of any such alternative. The court cited the al-

the court determined that, under the ban, there did not exist for telephone companies ample alternative methods of communication.[96]

47. In *U S West v. U.S.*, the Court of Appeals for the Ninth Circuit agreed with the Fourth Circuit that (assuming it served a significant government interest) the ban was not sufficiently narrowly tailored. The court found that the evidence submitted by U S West demonstrated that the procompetitive goals of the ban can be "achieved through a variety of less speech-restrictive means."[97] Unlike the Fourth Circuit, however, the Ninth Circuit, determining that it was unnecessary to do so, did not reach the issue of the availability of "ample alternative channels of communication."[98]

48. With respect to all proposals set forth above for safeguards on LEC provision of video programming, we seek comment on whether such safeguards, whether individually, or in any combination, would be consistent with the First Amendment, the Fourth Circuit's decision in *C&P Tel. Co. v. U.S.*, and the Ninth Circuit's decision in *U S West v. U.S.*

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ternative "not to imply *its* constitutionality, but only to show [the ban] itself is unconstitutional." *Id.* at 39 n.34.

[96] *Id.* at 40.

[97] *U S West v. U.S.* slip op. at 15910.

[98] *Id.* at 15913.

APPENDIX F

FCC 95-203

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

CC Docket No. 87-266

IN THE MATTER OF

TELEPHONE COMPANY-CABLE TELEVISION
Cross-Ownership Rule,
Sections 63.54-63.58

THIRD REPORT AND ORDER

Adopted: May 16, 1995

Released: May 16, 1995

By the Commission:

I. INTRODUCTION

1. In this *Third Report and Order*, we adopt the tentative conclusion set forth in the *Fourth Further Notice of Proposed Rulemaking* ("*Fourth FNPRM*")[1] in the above captioned docket regarding our legal authority to waive Section 613(b) of the Communications Act, 47 U.S.C. § 533(b). Section 613(b) generally prohibits telephone companies from providing "video programming directly to subscribers in the[ir] telephone service area." However, the statute expressly authorizes us to waive the re-

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[1] *Telephone Company-Cable Television Cross-Ownership Rules, Sections 63-54-63.58*, FCC 95-20, Fourth Further Notice of Proposed Rulemaking (released Jan. 20, 1995) ("*Fourth FNPRM*").

striction "where the provision of video programming directly to subscribers through a cable system demonstrably could not exist except through a cable system owned by" a telephone company "or upon other showing of good cause." For the reasons set forth below, we conclude that Section 613(b)(4) authorizes us to grant waivers to allow telephone companies to provide video programming directly to subscribers in their telephone service areas under certain conditions. In particular, in response to decisions of the Fourth and Ninth Circuits, we conclude that under Section 613(b)(4) we have the legal authority to grant waivers allowing telephone companies to provide video programming in their telephone service areas on video dialtone networks. We adopt that construction of the waiver provision because it is fully consistent with the language of the statute and Section 613(b)'s underlying policy, and because waiving the restriction in that manner obviates the constitutional infirmities identified by the courts of appeals. We do not decide any other issues raised in the *Fourth FNPRM* in this Order. In particular, we do not decide whether telephone companies may provide video programming over video dialtone networks rather than as traditional cable operators. In addition, if a telephone company is permitted to provide video programming on a video dialtone system, we are not here deciding whether that telephone company should be regulated under Title II or Title VI of the Communications Act. Nor do we decide the conditions under which telephone companies may be granted waivers to provide traditional cable service in their telephone service areas. Those issues and others will be decided in a subsequent order.

II. BACKGROUND AND SUMMARY

2. Section 613(b), which is sometimes referred to as the "cable-telco cross-ownership rule," prohibits a telephone company from operating a cable system where it has a monopoly on local telephone service. More spe-

cifically, although Section 613(b) does *not* bar a telephone company from acting as a conduit to carry video programming selected and provided by an unaffiliated party, it *does* generally bar a telephone company from selecting (or "exerting editorial control over") and providing the video programming carried over its wires in its local service area. Two courts of appeals, the Fourth and Ninth Circuits, have recently held Section 613(b) unconstitutional.[2] At the heart of both decisions is the conclusion that the statute unnecessarily limits speech by telephone companies because it prohibits them from choosing the video programming to be provided in their local exchange telephone service areas *altogether*. In so holding, both courts referred to the Commission's 1992 recommendation to Congress in our video dialtone docket, a proposal that the Ninth Circuit described in *US West* as a "more speech-friendly plan" than the absolute ban contained in the statute.[3] Under the Commission's legislative recommendations, as described by the Fourth Circuit in *C&P*, "telephone companies' editorial control over video programming [would be limited] to a fixed percentage of the channels available; the telephone companies would be required to lease the balance of the channels on a common carrier basis to various video programmers."[4] In short, the courts of appeals have held that a complete ban on editorial control over video programming in a telephone company's service area "'burden[s] substantially more speech than is necessary,'" especially since

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[2] *See US West, Inc. v. United States*, 48 F.3d 1092 (9th Cir. 1995) (*US West*); *Chesapeake and Potomac Tel. Co. v. United States*, 42 F.3d 181 (4th Cir. 1994) (*C&P*).

[3] *US West*, 48 F.2d at 1105, citing *Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking*, 7 FCC Rcd 5781, 5850 (1992) (*Video Dialtone Order*).

[4] *C&P*, 42 F.3d at 202, citing *Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking*, 7 FCC Rcd 5781, 5850-5851 (1992).

there appeared to be an " 'obvious less-burdensome alternative[]' "—allowing the telephone company to provide some video programming in their telephone service areas on a video dialtone system.[5]

3. We now conclude, as we previously proposed in the *Fourth FNPRM*, that we have the authority to grant waivers to telephone companies pursuant to Section 613(b)(4) allowing them to provide video programming directly to subscribers in their telephone service areas over video dialtone networks. Section 613(b)(4) provides that upon a showing of "good cause" the Commission may waive the cable-telco cross-ownership restriction where a waiver is "justified by the particular circumstances . . ., taking into account the policy" underlying the cross-ownership restriction.[6] Our current video dialtone rules, which are based on fundamental principles of common carriage, are designed to enhance competition in the multichannel video distribution market by providing multiple video programmers access to end user subscribers over the telephone company's network.[7] Consistent with

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[5] *Id.*, quoting *Ward v. Rock Against Racism*, 491 U.S. 781, 799 (1989), and *Chesapeake & Potomac Tel. Co. v. United States*, 830 F. Supp. 909, 930 (E.D. Va. 1993).

[6] We have waived the cable-telco cross-ownership rules on a number of occasions. Typically, these waivers have been sought on a temporary basis for experimental purposes, or to allow telephone companies to come into compliance with our cross-ownership rules by, for example, divesting cable holdings acquired after mergers. *See, e.g., Time Warner Entertainment Co., L.P. and U S West Communications, Inc.*, 8 FCC Rcd 7106 (1993).

[7] *See Video Dialtone Order*, 7 FCC Rcd 5781 (1992), *aff'd in part and modified in part on recon.*, 10 FCC Rcd 5781 (1994) *Telephone Company-Cable Cross-Ownership Rules, Section 63.54-65.58, Memorandum Opinion and Order and Reconsideration and Third Further Notice of Proposed Rulemaking (Video Dialtone Reconsideration Order), petition for review pending sub nom. Mankato Citizens Tel. Co. v. FCC*, No. 92-1404 (D.C. Cir. Sept. 9, 1992).

this common carrier model, our current video dialtone rules generally preclude any one programmer from serving as an "anchor programmer" and hence monopolizing the channels on the system. Waivers authorizing telephone companies to provide video programming in those circumstances will advance the policy underlying the cross-ownership restriction, which was enacted to promote competition in the multi-channel video programming market.[8]

4. Construing the waiver provision to authorize telephone companies to provide video programming over video dialtone networks avoids the constitutional infirmity identified by the Fourth and Ninth Circuits by making available the " 'obvious less-burdensome alternative' " referenced by those courts.[9] Moreover, it is our duty to so construe the statute. The Supreme Court has recently reiterated in *United States v. X-Citement Video, Inc.* that "a statute is to be construed where fairly possible so as to avoid substantial constitutional questions." [10] Thus, as the agency charged with implementing the Communications Act, we should construe it in a manner that renders it constitutional, and the decisions invalidating Section 613(b)(4) plainly show that, absent a waiver allowing telephone companies to offer video programming over video dialtone networks, there is a serious question as to whether Section 613(b) unnecessarily burdens substantially more speech than is necessary to promote competition in the multi-channel video programming market.[11]

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[8] *See NCTA v. FCC*, 914 F.2d 285, 287 (D.C. Cir. 1990) ("the policy [of Section 613(b)] is to promote competition").

[9] *See C&P*, 42 F.3d at 202; *US West*, 48 F.3d at 1104.

[10] *United States v. X-Citement Video*, 115 S. Ct. 464, 467 (1994).

[11] While the courts have identified video dialtone as a possible means by which telephone companies could provide programming in their service areas to remedy the constitutional infirmities of Section 613(b), and while we agree with the suggestion of these

5. In light of the ongoing litigation concerning the constitutionality of Section 613(b), we have decided to adopt the construction of Section 613(b)(4) that we proposed in the *Fourth FNPRM* before answering the other questions presented in this rulemaking. The Supreme Court will soon have to decide whether to review the Fourth Circuit's decision in the *C&P* case. A rehearing petition is pending in the Ninth Circuit in the *US West* case.[12] In addition, a number of district courts have issued injunctions barring enforcement of Section 613(b), and some of those decisions have been appealed.[13] By implementing a "more speech-friendly plan" pursuant to the waiver authority granted in Section 613(b)(4), we make it unnecessary for those courts to decide whether a complete prohibition on video programming by telephone companies in their exchange areas is constitutional.

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courts that waiving Section 613(b) as discussed above will cure these constitutional infirmities, we will address the terms and conditions under which telephone companies should be permitted to provide video programming directly to subscribers in their local service areas in a subsequent order addressing the other issues raised in the *Fourth FNPRM*.

[12] In February, the government suggested that the Ninth Circuit hold the rehearing petition in abeyance while the Commission considers the issue we decide today, and the Ninth Circuit has not yet acted on the rehearing petition. *See* Appellants' Petition for Rehearing and Suggestion for Rehearing *En Banc*, Ninth Cir. No. 94-35775 (filed Feb. 10, 1995).

[13] *See NYNEX Corp. v. United States*, No. 93-1523 (D. Me. December 8, 1994); appeal pending 1st Cir. No. 95-1183; Ameritech Corp. v. United States, 867 F. Supp. 721 (N.D. ILL. 1994), appeal pending 7th Cir. No. 95-1223; *BellSouth Corp. v. United States*, Civ. A. No. 3-93-1024 (N.D. Ala. 1994), appeal pending 11th Cir. No. 94-7036; *United States Telephone Association v. United States*, No. 1:94CV1961 (D.D.C.), appeal pending D.C. Cir. No. 95-5117; *Southwestern Bell Corporation v. United States*, Civil Action No. 3:94-C-0193-D (N.D. Tex. March 27, 1995); and *Southern New England Telephone Co.*, No. 3:94-CV-80 (DJS) (D. Conn. April 28, 1995).

III. DISCUSSION

6. On account of the cable-telco cross-ownership ban, in our initial video dialtone orders we envisioned telephone companies providing a common carrier platform over which others would transmit programming.[14] In the ongoing trials of video dialtone service, some programmers are "packagers"—that is, they provide packages of multiple channels, much like a cable operator—while other programmers provide individual channels. In light of the court decisions granting injunctions to telephone companies barring the enforcement of the cable-telco cross-ownership rule,[15] we have authorized two telephone companies conducting video dialtone trials to select and provide some of the video programming to be carried over their video dialtone systems subject to certain conditions adopted in those orders and any subsequent safeguards that the Commission determines will be necessary.[16] In the *Fourth FNPRM*, we asked for comment on

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[14] *See Video Dialtone Order*, 7 FCC Rcd 5781 (1992); *Video Dialtone Reconsideration Order*, 10 FCC Rcd 244 (1994).

[15] *See Chesapeake & Potomac Tel. Co. v. United States*, 42 F.3d 181 (4th Cir. 1994), rehearing denied (Jan 18, 1995); *US West, Inc. v. United States*, 855 F. Supp. 1184 (W.D. Wash. 1994), *aff'd*, *US West, Inc. v. United States*, 48 F.2d 1092 (9th Cir. 1995); *BellSouth Corp. v. United States*, 868 F. Supp. 1335 (N.D. Ala. 1994); *Ameritech Corp. v. United States*, 867 F. Supp. 721 (N.D. Ill. 1994); *NYNEX Corp. v. United States*, No. 93-1523 (D. Me. Dec. 8, 1994); *GTE South, Inc. v. United States*, No. 94-1588-A (E.D. Va. January 13, 1995); *Southwestern Bell Corporation v. United States*, Civil Action No. 3:94-C-0193-D (N.D. Tex. March 27, 1995); *United States Tel. Ass'n v. United States*, No. 1:94CVO1961 (D.D.C. Feb. 14, 1995); and *Southern New England Telephone Co.*, No. 3:94-CV-80 (DJS) (D. Conn. April 28, 1995).

[16] *See Bell Atlantic Telephone Companies, Order and Authorization*, FCC 95-15, File No. W-P-C 6834 (released Jan. 20, 1995) ("*Bell Atlantic Market Trial and Authorization*"); *BellSouth Telecommunications Inc., Order and Authorization*, DA 95-181, File No. W-P-C-6977 (Com. Car. Bur. released February 8, 1995) ("*Bell South Market Trial Order and Authorization*").

the terms and conditions under which local telephone companies should be permitted to provide video programming directly to subscribers in their local service areas. For instance, we asked whether we should permit them to do so over video dialtone systems.[17] A key issue in the *Fourth FNPRM* is whether such a telephone company is subject to regulation as a common carrier under Title II of the Communications Act, as a cable operator under Title VI of the Act, or under some combination of the statutory provisions governing those sorts of companies.[18] Additional issues involve the sorts of safeguards that are needed to ensure that the telephone company, acting in its capacity as the transporter of video signals, does not discriminate against independent programmers in favor of its affiliated programmer.[19] We do not resolve those issues or others posed by the *Fourth FNPRM* today. However, we construe Section 613(b)(4), the waiver provision, as authorizing us to permit telephone companies to act as programmers on video dialtone systems pursuant to certain conditions. The remaining issues raised in the *Fourth FNPRM* will be resolved in a further order in this proceeding.

7. Two statutory issues are presented in construing Section 613(b)(4): (1) whether "good cause" exists to waive the statutory restriction to permit a telephone company that wants to provide programming in its service area to do so over a video dialtone system, and (2) whether "the issuance of such waiver is justified by the particular circumstances demonstrated by the petitioner, taking into account the policy of this subsection," when a telephone company requests waiver of Section 613(b) to provide video programming over a video dialtone system.[20] The commenters have paid scant attention to these

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[17] *See Fourth FNPRM* at para. 10.

[18] *Id.* at para. 9.

[19] *Id.* at paras. 20-41.

[20] 47 U.S.C. Section 533(b)(4).

issues, but we believe that an explanation is warranted as to why there is good cause for granting a waiver under circumstances that will promote competition in the multichannel video programming market.

8. As the D.C. Circuit recognized in its 1990 *NCTA v. FCC* decision, "the policy [of Section 613(b)] is to promote competition."[21] Congress enacted Section 613 "to prevent the development of local media monopolies, and to encourage a diversity of ownership of communications outlets."[22] The House Report on the 1984 Cable Act explained that Congress's intent in enacting Section 613(b) was "to codify current FCC rules concerning the provision of video programming over cable systems by common carriers,"[23] and the Commission adopted those rules in 1970 to "preserv[e], to the extent practicable, a competitive environment for the development and use of broadband cable facilities and service and thereby avoid undue and unnecessary concentration of control over communications media either by existing carriers or other entities."[24] That is, when the Commission adopted its cable-telco cross-ownership rules in 1970, it sought to prevent the telephone companies from using their monopoly position to preempt the market for cable service by excluding others from entry.[25] The Commission explained

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[21] *NCTA v. FCC*, 914 F.2d at 287.

[22] H.R. Rep. No. 934, 98th Cong., 2d Sess. 55 (1984), *reprinted in* 1984 U.S.C.C.A.N. 4655, 4692.

[23] H.R. Rep. No. 934 at 56, *reprinted in* 1984 U.S.C.C.A.N. at 4693.

[24] *Applications of Telephone Companies for Section 214 Certificates for Channel Facilities Furnished to Affiliated Community Antenna Television Systems; Final Report and Order*, 21 FCC 2d 307, 325 (1970) (*"Cable-Telco Cross-Ownership Rules Order"*), *reconsidered in part*, 22 FCC 2d 746 (1970), *aff'd sub mon. General Tel. Co. of the Southwest v. United States*, 449 F.2d 846 (5th Cir. 1971).

[25] The Commission specifically sought to curtail the opportunities telephone companies would otherwise have to take advantage of

that it sought to avoid extending, "without need or justification, the telephone company's monopoly position to broadband cable facilities and the new and different services such facilities are expected to be providing in the future." [26] Since 1970, however, the cable industry has grown from a fledgling service to a more mature industry that now serves a majority of households and "has replaced over-the-air broadcast television as the primary provider of video programming." [27] While Congress's interest in promoting diverse information sources and discouraging anti-competitive abuses remains highly relevant in today's video marketplace, its concern with ensuring that the cable industry not be extinguished before it is established is no longer relevant. "Good cause" is a phrase that is commonly associated with changed circumstances.[28] The relevant circumstances have changed greatly since the Commission adopted its cross-ownership rules in 1970 and Congress "modeled [Section 613(b)] after the FCC['s] rules" [29] in 1984.

9. We also conclude that significant advances in technology have changed the circumstances relevant to determining whether telephone companies should be permitted to provide video programming directly to subscribers in their service areas.[30] When Congress enacted the cable-

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their monopoly control over the conduits and telephone poles required for the transmission of video programs to cable subscribers. *Cable-Telco Cross Ownership Rules Order*, 21 FCC 2d at 324.

[26] *Id.* at 324.

[27] *Turner Broadcasting System, Inc. v. United States*, 114 S. Ct. 2445, 2454 (1994), citing Section 2(a)(17) of the 1992 Cable Act.

[28] *See, e.g., Illinois v. ICC*, 713 F.2d 305, 310 (7th Cir. 1983); *Greyhound Corp. v. ICC*, 668 F.2d 1354, 1362 (D.C. Cir. 1981).

[29] *GTE California, Inc. v. FCC*, 39 F.2d 940, 942 (9th Cir. 1994) (*GTE California*).

[30] Technological advances have long been an accepted basis upon which good cause has been found to justify waiving the cable-telco cross-ownership restriction. In its 1978 *Clarification Order*, the

telco cross-ownership restriction, telephone companies did not have the technology available to them to deliver video signals over the networks they used to provide common carrier telephone service, much less the capability and capacity to provide access to a multitude of video programmers. However, as the D.C. Circuit has recently recognized, since the mid-1980s "technology was advancing rapidly and the once clear line between the provision of video and the provision of voice service was blurring."[31] That is, fiber-optic systems, digitization, and other technological advances have made it possible to transmit video signals over integrated facilities rather than over separate networks and have greatly expanded the capacity of these facilities.[32] These developments have made it possible for a multitude of programmers to reach end user customers and have mitigated to a fair degree the competitive concerns that led the Commission and Congress to adopt the cross-ownership ban. These technological developments also support the conclusion that "good cause" exists to authorize telephone companies to provide video programming within their service areas where that will promote competition in the multichannel video programming market.

10. We also conclude that the rules we will promulgate in the immediate future to authorize telephone companies to provide video programming in their service areas will constitute "particular circumstances . . .. taking into account the policy" of Section 613(b). While we

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Commission clarified the criteria we would use in granting good cause waivers; the Commission stated that, in particular, we would consider recent technological developments as a justification for a good cause waiver. This standard was cited with approval by the court in *NCTA v. FCC* (1990). *Revision of the Processing Policies for Waivers of the Telephone Company-Cable Television "Cross Ownership Rules"*, 69 FCC 2d 1097, 1110-111 (1978) (*"Clarification Order"*); *NCTA v. FCC* (1990), 914 F.2d at 289.

[31] *NCTA v. FCC*, 33 F.3d 66, 69 (D.C. Cir. 1994).

[32] *See id.*

have not yet adopted definitive rules governing the conditions under which telephone companies may be permitted to act as video programmers over their video dialtone systems, the outline of two of those requirements is clear. First, video dialtone necessarily includes a common carriage element, and we have previously concluded that a telephone company may not allocate all or substantially all of its capacity to a single "anchor programmer."[33] Accordingly, a telephone company providing video dialtone service is not allowed to occupy all of the channels provided by the system, but has a common carrier obligation to make capacity available to others.[34] The common carrier aspect of video dialtone service promotes both competitive and free speech interests by making room for more than one speaker. Second, our current video dialtone rules contain provisions intended to ensure that telephone companies providing video programming directly to subscribers do not discriminate in favor of their affiliated programmers and do not subsidize video programming operations with rates collected from their provision of monopoly telephone services.[35] These restrictions are

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[33] *Video Dialtone Reconsideration Order*, 10 FCC Rcd at 260.

[34] In authorizing Bell Atlantic and BellSouth to provide programming to subscribers a part of their video dialtone trials, we required them to make 50% of their system's capacity available to unaffiliated programmers. *See Bell Atlantic Market Trial and Authorization* at paras. 31, 65(d); *BellSouth Market Trial and Authorization* at paras. 17, 52(a).

[35] The Commission has developed a number of safeguards that are designed to prevent cross-subsidization and discrimination when telephone companies provide "enhanced services." The safeguards against cross-subsidization include accounting and cost allocation rules that separate nonregulated service costs from the costs associated with providing basic regulated telephone service. The non-discrimination safeguards include a variety of rules designed to ensure that unaffiliated enhanced service providers have access to the network on the same basis as affiliated enhanced service providers and are not otherwise unfairly disadvantaged. In the ongoing rulemaking proceeding in this docket, we will decide what

intended to promote the underlying purpose of Section 613(b) by fostering fair competition in the multi-channel video programming market.[36]

11. Construing the waiver provision to authorize telephone companies to provide video programming pursuant to our video dialtone rules obviates the constitutional difficulties associated with Section 613(b). Specifically, the Fourth Circuit and Ninth Circuit have held that the cable-telco cross-ownership restriction "burden[s] substantially more speech than is necessary" to promote the government's interest in promoting a competitive multichannel video programming market.[37] Waiving Section 613(b) to allow telephone companies to offer video programming in their service areas over video dialtone platforms, however, constitutes implementation of the "obvious less burdensome alternative" to the ban identified by the Fourth Circuit.[38] Or, to quote the Ninth Circuit, it implements the "more speech-friendly plan" that allows telephone companies "to compete in the video programming market" while "requiring that a portion of their transport volume be set aside for sale to unaffiliated third parties on a common carrier basis."[39] As a result of our construc-

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safeguards are needed when telephone companies provide video programming over video dialtone systems.

[36] It is possible that we will decide in the ongoing rulemaking proceeding that telephone companies ought to be permitted to provide traditional cable service, rather than participate as programmers on video dialtone systems, under "particular circumstances" that will promote competition in the multichannel video programming market.

[37] *See C&P*, 42 F.3d at 202.

[38] We recognize that the Fourth Circuit reserved judgment on the constitutionality of our recommended model. *C&P*, 42 F.3d at 202 n.34. However, if that recommended approach does not render the statute constitutional then, contrary to the court's holding, it is not an " 'obvious less-burdensome alternative,' " because it is no alternative at all. *Id.* at 202.

[39] *US West*, 48 F.3d at 1105.

tion of the waiver provision, telephone companies' free speech interests are not unduly burdened. Telephone companies have always been permitted to provide video programming directly to subscribers in all areas of the country outside of their service areas. In addition, they may produce video programming and provide it to unaffiliated broadcasters, cable operators, or other mass media outlets both within and outside of their service areas.[40] Pursuant to the reading of the waiver provision we adopt today, telephone companies also may seek a waiver of the statutory restriction in order to provide programming directly to subscribers over video dialtone facilities where they have a monopoly on local exchange telephone service. Thus, under our reading of the statute, telephone companies have abundant opportunities to speak.

12. The fact that waiver of the cable-telco cross-ownership restriction obviates the constitutional difficulties identified by the courts of appeals supports our decision to construe our waiver authority to permit telephone companies to provide video programming over video dialtone systems. As the Supreme Court recently reiterated in *X-Citement Video*, "a statute is to be construed where fairly possible so as to avoid constitutional questions."[41] In other words, when given a choice between a permissible construction that would avoid constitutional problems and one that raises constitutional doubts, "[i]t is incumbent upon us to read the statute to eliminate those doubts so long as such a reading is not plainly contrary to the intent of Congress."[42] The Court also articulated this principle in *Jean v. Nelson*, when it found that "[p]rior to reaching any constitutional questions federal courts must consider nonconstitutional grounds for decision."[43]

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[40] *Video Dialtone Reconsideration Order*, 10 FCC Rcd at 280-281.

[41] *X-Citement Video*, 115 S.Ct at 467.

[42] *Id.* at 462.

[43] *Jean v. Nelson*, 472 U.S. 846, 854 (1985), *quoting* Gulf Oil Co. v. Bernard, 452 U.S. 89, 99 (1981).

13. While the majority of commenters did not address the waiver issue, there was support among the commenters for our reading of the statute.[44] Several commenters, however, opposed our reading of the waiver provision, including a telephone company, Southwestern Bell, which argues that our proposal constitutes an evisceration of the rule.[45] That is not so. As we have explained, the purpose of the rule is to promote competition. It generally would not promote competition to allow a telephone company to purchase an incumbent monopolist cable operator in the telephone company's service area. But it *does* promote competition to allow a telephone company to provide video dialtone service in its telephone service area in competition with an existing cable company. Accordingly, it would eviscerate the statute if we were to waive Section 613(b) to allow telephone companies to provide video programming directly to subscribers in their service areas over video dialtone facilities *and*, as a general matter, to purchase cable systems in their telephone service areas that do not face competition. But we are not authorizing such waivers in this order. Instead, we conclude only that Section 613 (b)(4) authorizes us to waive the cable-telco cross-ownership rule to permit a telephone company to provide video programming over video dialtone systems in its telephone service area in competition with existing cable operators, a result that *furthers* the purpose of the rule.[46]

14. Both the United States Telephone Association and US West invoke *Secretary of State of Maryland v. Mun-*

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[44] *See* Comments of Southern New England Telephone.

[45] *See* Comments of Southwestern Bell at 43.

[46] We do not decide today whether we could grant a waiver authorizing a telephone company to build a traditional cable system in its telephone service area in competition with an existing cable system. Nor do we address the conditions under which a waiver might be warranted to allow a telephone company to purchase an in-region cable system.

sun[47] to argue that the statute cannot be saved by its waiver provision.[48] But this case is not at all similar to *Munson*. The *Munson* case involved a 25% limitation on the percentage of funds a charitable organization could keep, on the theory that a charity that used less than 75% of the funds that it raised on charitable purposes was engaged in fraud. The Court invalidated the state statute imposing the limitation upon concluding that "[t]he flaw in the statute is not simply that it includes within its sweep some impermissible applications, but that in all its applications it operates on the fundamentally mistaken premise that high solicitation costs are an accurate measure of fraud."[49] Moreover, the Court concluded that the statute stifled speech and discriminated against certain viewpoints, explaining that "the statute will restrict First Amendment activity that results in high costs but is itself a part of the charity's goal or that is simply attributable to the fact that the charity's cause proves to be unpopular."[50] The Court went on to hold that the statute was not saved by a provision allowing for waivers of the limitation. The Court stated that "[b]y placing discretion in the hands of an official to grant or deny a license, such a statute creates a threat of censorship that by its very existence chills free speech."[51] "Particularly where the percentage limitation is so poorly suited to accomplishing the State's goal," the Court added, "and where there are alternative means to serve the same purpose, there is little justification for straining to salvage the statute by invoking the possibility of official dispensation to engage in protected activity."[52] In this case,

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[47] *Secretary of State of Maryland v. Munson*, 467 U.S. 947 (1984).

[48] USTA Comments at 6; US West Reply Comments at 6.

[49] *Munson*, 467 U.S. at 966.

[50] *Id.* at 967.

[51] *Id.* at 964 n.12.

[52] *Id.*

in contrast, permitting telephone companies to provide video programming over a video dialtone system plainly advances the goal of making programming from a variety of sources available to the public—a goal that furthers rather than hinders First Amendment interests. Unlike *Munson*, speech is not stifled and unpopular viewpoints are not disadvantaged. Moreover, no discretion remotely comparable to that in *Munson* would be lodged in any official to grant or deny particular waivers under our approach. Rather, as part of any decision under 47 U.S.C. § 214 authorizing a telephone company to construct facilities, we will routinely grant a waiver of Section 613(b) where the telephone company agrees to abide by the regulations we will establish governing its provision of video programming. Accordingly, there is no "threat of censorship that by its very existence chills free speech." [53]

15. In light of our duty to interpret Section 613(b) in a fashion that renders the statute constitutional, there is no merit at all to the suggestion by some commenters that the Commission's interpretation of Section 613 (b)(4) is barred by res judicata, collateral estoppel,[54] or some unnamed principle that allegedly prevents the Commission from construing a statute that a court has held unconstitutional.[55] In *X-Citement Video*, the Supreme Court read the federal child pornography statute in a manner that the Court acknowledged was not its "most natural grammatical reading" in order to avoid a serious constitutional issue after a court of appeals had held the statute unconstitutional.[56] In particular, the Court held that the statute required the government to

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[53] *Id.*

[54] *See* Comments of Ameritech at 7.

[55] *See, e.g.*, Comments of Bell Atlantic at 29-30; Comments of NYNEX at 29; Comments of Southwestern Bell at 43; Reply Comments of US West at 6.

[56] *X-Citement Video*, 115 S.Ct. at 467.

prove that the defendant in a child pornography case knew that the material on which the prosecution was based contained child pornography even though the statute did not appear to contain such a scienter requirement.[57] In this case, in contrast, the language of the waiver provision is flexible, speaking of "good cause" and "particular circumstances . . ., taking into account the policy of this subsection." Unlike the Court in *X-Citement Video*, we do not have to strain to construe the waiver provision so that it renders the statute constitutional. Rather, as we have explained, we believe that such an interpretation is fully consistent with both the language of the waiver provision and the policy underlying Section 613(b), and therefore is the best interpretation of Section 613(b)(4). For those reasons, and in light of the fact that such an interpretation also avoids a serious constitutional issue, we now adopt our tentative conclusion that the waiver provision should be interpreted to authorize us to consider and approve requests by telephone companies to provide video programming over video dialtone systems, subject to the rules we have enacted and any further rules we will enact to govern video dialtone systems.

16. Finally, we also conclude that our reading of Section 613(b)(4) is not foreclosed by the D.C. Circuit's 1990 decision in *NCTA v. FCC*. That case did not involve video dialtone service and presented no constitutional issue. It instead involved a waiver of FCC cross-ownership rules authorizing a cable operator to provide cable service over a telephone companies' wires even though the cable operator was affiliated with the telephone company in violation of the rules by virtue of their joint interest in the contractor that was to build the cable system. The court acknowledged that the project

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[57] In fact, the dissenters in that case said that the Court gave the statute a construction "that its language simply will not bear." *Id.* at 473.

"presents a number of advantages that might justify a good cause waiver." [58] However, it held that the Commission had "failed . . . to explain why any of these advantages require [the contractor's] participation as [the telephone companies'] contractor." [59] In this case, in contrast, in light of the decisions holding Section 613(b) unconstitutional, it is necessary to waive Section 613(b) to allow affiliates of telephone companies to provide video programming in order to render the statute constitutional. The Ninth Circuit recognized that a waiver might be warranted in these circumstances in *GTE California, Inc. v. FCC*,[60] a case that (unlike *NCTA v. FCC*) involved a constitutional challenge to Section 613(b). The Ninth Circuit stated in that case, in response to the argument that Section 613(b) is unconstitutional, that "GTECA did not present the constitutional issue to the Commission at a point in this proceeding where it could have tried to obviate the constitutional question by granting discretionary relief, such as a permanent waiver." [61] As that statement recognizes, a waiver is warranted to implement what the Ninth Circuit in *US West* termed our "more speech-friendly plan" [62] and hence avoid a serious constitutional issue.

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[58] *NCTA v. FCC*, 914 F.2d at 289.

[59] *Id.*

[60] *GTE California, Inc. v. FCC*, 39 F.3d 940 (1994).

[61] *Id.* at 946.

[62] *US West*, 48 F.3d at 1105.

III. CONCLUSION

17. Accordingly, IT IS ORDERED that Section 613 (b)(4) of the Communications Act is interpreted to authorize waivers permitting telephone companies to provide video programming directly to subscribers in their telephone service area pursuant to the rules we will adopt in this docket or related rulemaking proceedings.

FEDERAL COMMUNICATIONS COMMISSION

WILLIAM F. CATON
Acting Secretary

(18) (17)

Nos. 94-1893, 94-1900

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UNITED STATES OF AMERICA, *et al.*,

Petitioners,

v.

CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA, *et al.*,

Respondents.

ON WRITS OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

BRIEF FOR RESPONDENTS

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RULE 29.1 STATEMENT

Respondents hereby incorporate the Rule 29.1 statement in the Response to the Petitions for Certiorari.

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BRIEF FOR RESPONDENTS

STATEMENT OF THE CASE

This case concerns the constitutionality of a federal statute, 47 U.S.C. § 533(b), which prohibits local telephone companies from providing video programming directly to subscribers in their telephone service areas. Section 533(b)(1) forbids telephone companies from "provid[ing] video programming" *in any way* "directly to subscribers" — whether they create such programming from scratch or instead edit and arrange programs created by others into a "programming" package.[1] Section 533(b)(2) bans telephone companies from providing this programming using their own facilities.[2] Together, these provisions constitute a ban on the expressive process of providing video programming of one's choice — *i.e.*, a ban on the editorial process itself.

Every one of the 16 federal judges who has considered the question has concluded that § 533(b) is invalid under the First Amendment. Every one of the agencies with responsibility over federal telecommunications policy has recommended the elimination of § 533(b), on the ground that the statute positively disserves any governmental interest in protecting consumers and fostering competition. Each House of Congress has now voted to repeal

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[1] Section 533(b)(1) provides:

> It shall be unlawful for any common carrier, subject in whole or in part to title II of [the Communications] Act, to provide video programming directly to subscribers in its telephone service area, either directly or indirectly through an affiliate owned by, operated by, controlled by, or under common control with the common carrier.

[2] Section 533(b)(2) provides:

> It shall be unlawful for any common carrier, subject in whole or in part to title II of [the Communications] Act, to provide channels of communications or pole line conduit space, or other rental arrangements, to any entity which is directly or indirectly owned by, operated by, controlled by, or under common control with such common carrier, if such facilities or arrangements are to be used for, or in connection with, the provision of video programming directly to subscribers in the telephone service area of the common carrier.

§ 533(b). A ban on speech so thoroughly repudiated cannot survive any form of First Amendment scrutiny.

A. THE HISTORY OF SECTION 533(b)

1. Section 533(b) had its genesis in a restriction imposed on telephone companies by the Federal Communications Commission ("FCC") in 1970. At that time, cable television — known as CATV ("community antenna television") service — was in its infancy. CATV operators built large antennas in rural areas and other places unable to receive clear television signals over the air and then strung cables, often on telephone or electric utility poles, from each central antenna to the CATV customers. Pet. App. 57a.[3]

CATV operators generally did not create, package, or arrange video programming. "Essentially, a CATV system no more than enhance[d] the viewer's capacity to receive the broadcaster's signals." *Fortnightly Corp. v. United Artists Television, Inc.*, 392 U.S. 390, 399 (1968). Under these circumstances, the prevailing understanding was that restrictions on CATV service did not implicate the First Amendment at all. *Id.*; *see also Buckeye Cablevison, Inc. v. FCC*, 387 F.2d 220, 225 (D.C. Cir. 1967).

In 1970, the FCC issued regulations prohibiting telephone companies from providing CATV service to their local subscribers and from furnishing pole attachments, conduit space, or other facilities to themselves or any affiliated entity for purposes of providing such service.[4] The FCC feared that "the telephone

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[3] References to the decisions of the District Court and Court of Appeals, as reprinted in the Appendix to the Government's Petition for Certiorari, are styled "Pet. App. __a." References to the Federal Communications Commission's *Third Report and Order*, FCC 95-203 (May 16, 1995) are styled "Supp. Br. App. __a." References to the Joint Appendix in this Court are styled "JA __." References to the Joint Appendix in the Court of Appeals are styled "Ct. App. JA __." References to the Brief of the Federal Petitioners in No. 94-1893 are styled "Govt. Br. __." References to the Brief of Petitioner NCTA in No. 94-1900 are styled "NCTA Br. __."

[4] Final Report & Order, *Applications of Telephone Common Carriers for Section 214 Certificates*, 21 F.C.C. 2d 307 (1970) ("1970 FCC Order"), *codified at* 47 C.F.R. § 64.601 (1971).

companies had the potential to discriminate against independent CATV providers, in favor of telephone company affiliates, in granting access to telephone poles for attachment of the CATV cables." Pet. App. 59a (citing 1970 FCC Order at 324). The Commission was also concerned that telephone companies might "preempt the market" in the "new and emerging" field of CATV service before independent operators had an opportunity to deploy their networks. 1970 FCC Order at 324, 325. The Commission referred to pole and conduit access as "the potential seedbed of the controversy." *Id.* at 326. Acknowledging that it was "impossible to foresee" how the CATV industry would develop over the longer term, the FCC promised to reassess the matter in due course. *Id.* at 329.

2. Congress addressed the FCC's concern about telephone company control of poles by enacting the Federal Pole Attachment Act of 1978, codified at 47 U.S.C. § 224. The Act authorizes the FCC, together with state officials, to regulate the rates, terms, and conditions of pole access for cable companies. *Id.* at § 224(b)(1). Immediately after the Act's passage, the FCC established a mathematical formula for determining "just and reasonable" attachment rates, 47 C.F.R. § 1.1409(c), and mutually acceptable contracts were soon hammered out in every locality. Notice of Inquiry, *Telephone Company-Cable Television Cross-Ownership Rules*, 2 FCC Rcd 5092, 5093-5094 (1987); JA 174-75.

3. Section 533(b) was adopted as part of the Cable Communications Policy Act of 1984 (the "1984 Cable Act"), Pub. L. No. 98-549, 98 Stat. 2779 (codified at 47 U.S.C. § 521 *et seq.*), the principal purpose of which was to deregulate the cable industry. As the District Court observed, "[l]egislative materials relating to § 533(b) are sparse. No legislative findings of fact accompanied the provision." Pet. App. 61a. The most pertinent "reference to § 533(b) in the legislative history of the 1984 Cable Act is a passage in the House Committee Report, which indicates that the intent of the provision was 'to codify current FCC rules concerning the provision of video programming over cable systems by common carriers.'" *Id.* (quoting H.R. Rep. No. 934, 98th Cong., 2d Sess. 56 (1984)). The same Committee Report explained, however, that the bill was not intended to prevent telephone companies from

transporting the video speech of others, but only from providing speech of their own. H.R. Rep. No. 934 at 57.

B. THE ORIGINAL BASES FOR THE BAN HAVE BEEN ELIMINATED BY CHANGED CIRCUMSTANCES

1. Since 1970, the cable industry has grown from a marginal supplier of passive antenna service to "our Nation's dominant video distribution medium." S. Rep. No. 92, 102d Cong., 1st. Sess. 3 (1991). In 1970, "CATV reached only approximately 9% of all homes and mainly consisted of small, limited capacity systems in remote communities." Pet. App. 65a. Now, cable television is available to 98% of the nation's homes, and at least 60% of the television households subscribe. *U S West, Inc. v. United States*, 48 F.3d 1092, 1102 (9th Cir. 1994), *petition for cert. pending*, No. 95-315; *see also* JA 197, 198.

In the Cable Television Consumer Protection and Competition Act of 1992, 106 Stat. 1460 ("1992 Cable Act"), Congress documented the "undue market power" of cable operators which has resulted in "barriers to entry for new programmers and a reduction in the number of media voices available to consumers." §§ 2(a)(2), 2(a)(4), 106 Stat. 1460. *See generally Turner Broadcasting System, Inc. v. FCC*, 114 S. Ct. 2445, 2454-55 (1994). "Despite Congressional efforts to promote competition in the cable industry, the provision of cable television has remained a monopoly service in virtually every community." Pet. App. 66a. Fewer than 1% of cable markets are competitive. JA 199; *see also Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 9 FCC Rcd 7442, at ¶ 13 (Sept. 28, 1994) (*1994 Competition Report*).

2. Technology has also changed dramatically since § 533(b) was adopted. In 1984, it was not feasible for telephone companies to provide video programming over the basic telephone network. JA 138. Even as recently as 1991, a Senate committee report assumed that "telephone company networks are incapable of carrying video signals to the home." S. Rep. No. 92, 102d Cong., 1st Sess. 18 (1991). Today, however, telephone companies can provide video programming over the telephone network, JA 138-

40, offering many new channels of communication to compete with incumbent cable monopolists. As the District Court observed, § 533(b) now excludes "the one class of potential competitors that has exhibited an inclination to compete with the entrenched monopolists [and] clearly operates in the first instance to restrict competition in the market for video programming." Pet. App. 96a.

3. In addition, since 1984, regulators have developed an entirely new set of rules governing telephone company provision of services like video programming. These rules prohibit anti-competitive acts and thus directly target all of the interests identified by the Solicitor General. Both the FCC and the Department of Justice have repeatedly concluded that the rules are fully effective. "Whatever might have been possible prior to the break-up of the unified Bell System, or before we instituted a comprehensive package of regulatory safeguards, the reality today is that the FCC does have effective tools, and has clearly demonstrated both the willingness and ability to use them." JA 352-53 (FCC Chairman Sikes); *see also* JA 355 ("the Department [of Justice] disagrees with those commentators who argue that the [FCC's] rules are inadequate to protect against anticompetitive conduct").

4. These changed circumstances have led every expert telecommunications agency, during both Republican and Democratic Administrations, to conclude that § 533(b) affirmatively *disserves* the very purposes that the petitioners claim it substantially furthers, and that the ban should be eliminated.[5]

After compiling a full administrative record over five years, in 1992 the FCC formally recommended the removal of § 533(b) on the ground that such action would "increas[e] competition in the video marketplace, spur[] the investment necessary to deploy an advanced infrastructure, and increas[e] the diversity of services made available to the public."[6] According to the FCC, lifting § 533(b) "would result in significant price savings for consumers."

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[5] The agencies' conclusions are excerpted at JA 337-60.

[6] JA 337 (citation omitted); *see also* Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking, *Telephone Company-Cable Television Cross-Ownership Rules*, 7 FCC Rcd 5781, 5820 (1992) ("*Video Dialtone Order*").

JA 339-40. Reed E. Hundt, the current Chairman of the FCC, has testified that removing § 533(b) would foster "facilities-based competition," "expand the electronic marketplace of ideas," and result in "technological and service innovation, lower prices, and responsiveness to consumer tastes." JA 376-77.

In November 1994, the Commission reiterated its recommendation that § 533(b) be eliminated and explained that any residual anticompetitive risk "can and should instead be addressed through . . . appropriate regulatory safeguards."[7] In May 1995, the FCC released its *Third Report and Order*, Supp. Br. App. 1a-21a, which announced a dramatic reinterpretation of the Commission's "good cause" waiver policy, in light of the FCC's finding that "routinely" *waiving*, rather than *enforcing*, the ban would "promote competition." *Id.* at 9a-10a, 19a.

The Department of Justice has similarly concluded that telephone company "provision of video programming will have procompetitive benefits that outweigh any anticompetitive risks involved." JA 342 (citation omitted). In congressional testimony, Anne K. Bingaman, the current Assistant Attorney General, Antitrust Division, recently reaffirmed that telephone companies should be permitted to offer "both video and telephonic services in the same geographic areas." JA 381.

The National Telecommunications and Information Administration (NTIA), a unit of the Department of Commerce, has similarly determined that lifting § 533(b) "would significantly increase competition in the video services market, which would, in turn, yield lower prices to viewers, better service quality, and better programming diversity." JA 346. NTIA has also concluded that § 533(b) is "inefficient and anticompetitive" and that the risks it purports to address "are either overstated or can be effectively ameliorated by adapting existing regulatory safeguards to suit the video programming marketplace." NTIA, *The NTIA Infrastructure Report, Telecommunications in the Age of Information* 235, 242 (1991) ("NTIA Infrastructure Report"); *see also* JA 382, 383.

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[7] Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, *Telephone Company-Cable Television Cross-Ownership Rules*, 10 FCC Rcd 244 at ¶ 265 (1994).

In January 1994, the Administration released its "White Paper on Communications Act Reforms," which advocated removing § 533(b): "Although the existing cable-telephone company cross-ownership restriction of the 1984 Cable Act may have been appropriate when enacted, today it is an unnecessary and artificial barrier to competition in the delivery of video programming to American consumers and to investment in advanced local infrastructure." JA 370.

5. Each House of Congress has voted to repeal § 533(b): on June 16, 1995, the Senate passed S. 652 by a vote of 81-18, and on August 4, 1995, the House adopted H.R. 1555 by a vote of 303-117. Members of Congress explained that "[t]he cable television market will be made fully competitive as telephone companies are given the right to offer cable television services. . . . Consumers will see many new services, lower prices, and greater choices. The bill will also encourage new investments by telecommunications companies, building for our nation the much heralded national information infrastructure." 141 Cong. Rec. H 8459 (Aug. 4, 1995) (Rep. Boucher); *see also* 141 Cong. Rec. H 8281 (Aug. 2, 1995) (Rep. Bliley). Sen. Lott called § 533(b) "the equivalent of an 'Edsel' in the space and information age." 141 Cong. Rec. S 7906 (June 7, 1995). Sen. Kerrey stated that, in the absence of the ban, "'telephone companies might have offered cable service two decades ago and perhaps have prevented cable television monopolies in local markets.'" 141 Cong. Rec. S 8194 (June 12, 1995) (internal quotation omitted).

C. THE PROCEDURAL HISTORY OF THIS CASE

Bell Atlantic filed its complaint in December 1992. JA 6. After informal discovery, the factual issues were fully developed in a record of several thousand pages consisting of a comprehensive stipulation of facts, numerous undisputed affidavits, and extensive exhibits. As the District Court remarked, "it is difficult to imagine a more complete record." Pet. App. 57a. The parties filed cross-motions for summary judgment, with no party suggesting that there was any issue of material fact that would prevent the court from deciding the case on the existing record. Although the District

Court observed that § 533(b) cannot "be applied without reference to the content of the message being conveyed," *id.* at 85a, the court believed that the statute nonetheless qualified as "content-neutral" under this Court's decision in *City of Renton v. Playtime Theatres, Inc.*, 475 U.S. 41 (1986). However, the District Court held that § 533(b) was a "draconian approach" that "does not fit with its asserted justification," Pet. App. 99a, 102a, and thus could not survive intermediate scrutiny.

The Court of Appeals also found that § 533(b) was content-neutral. Pet. App. 28a. But the court held that § 533(b) failed intermediate scrutiny because it was not narrowly tailored to the Government's asserted interests and failed to leave telephone companies with sufficient alternative channels for communication. *Id.* at 38a-51a.

Subsequently, nine additional, separate lawsuits challenging § 533(b) were filed across the Nation. Every one of the other federal courts to consider the question has agreed that § 533(b) violates the First Amendment.[8] Not a single judge has dissented.

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[8] In addition to the decisions below, see *U S West, Inc. v. United States*, 855 F. Supp. 1184 (W.D. Wash.), *aff'd*, 48 F.3d 1092 (9th Cir. 1994), *petition for cert. pending*, No. 95-315, 64 U.S.L.W. 3160 (Aug. 23, 1995); *Pacific Telesis Group v. United States*, 48 F.3d 1106 (9th Cir. 1994), *petition for cert. pending*, No. 95-315, 64 U.S.L.W. 3160 (Aug. 23, 1995); *BellSouth Corp. v. United States*, 868 F. Supp. 1335 (N.D. Ala. 1994), *appeal pending*, No. 94-7036 (11th Cir.); *Ameritech Corp. v. United States*, 867 F. Supp. 721 (N.D. Ill. 1994), *appeal pending*, No. 95-1223 (7th Cir.); *NYNEX Corp. v. United States*, No. 93-323-P-C (D. Me.) (Dec. 20, 1994), *appeal pending*, No. 95-1183 (1st Cir.); *GTE South, Inc. v. United States*, No. 94-1588-A (E.D. Va. Jan. 13, 1995), *appeal pending*, No. 95-1738 (4th Cir.); *United States Telephone Ass'n v. United States*, No. 1:94CV01961 (D.D.C. Feb. 14, 1995), *appeal pending*, No. 95-1175 (D.C. Cir.); *Southwestern Bell Corp. v. United States*, No. 3:94-CV-0193-D (N.D. Tex. Mar. 27, 1995), *appeal pending*, No. 95-10478 (5th Cir.); *Southern New England Telephone Co. v. United States*, No. 3:94-CV-80 (D. Conn. Apr. 27, 1995), *appeal pending*, No.95-6137 (2d Cir.); *see also GTE California, Inc. v. FCC*, 39 F.3d 940, 951 (9th Cir. 1994) (Noonan, J., dissenting) (concluding, where majority did not reach merits, that § 533(b) is "counterproductive. . . . It does not even survive rationality review.").

SUMMARY OF ARGUMENT

I. Section 533(b) is properly subject to invalidation under strict scrutiny for at least two separate reasons. First, it is a direct ban on speech — the editorial process of selecting, assembling, and packaging programming for provision directly to subscribers — and nothing but speech. Thus, § 533(b) bans the very acts that this Court has identified as warranting First Amendment protection in the cable context. *See Turner*, 114 S. Ct. at 2456.

Section 533(b) flatly excludes telephone companies from what is indisputably the Nation's most important medium of communication. JA 152-57. Although reasonable time, place, and manner rules are permissible, "[a]dditional restrictions such as an absolute prohibition on a particular type of expression will be upheld only if narrowly drawn to accomplish a compelling governmental interest." *United States v. Grace*, 461 U.S. 171, 177 (1983). This Court has made clear that "prohibitions foreclosing entire media" — particularly "important and distinct" media of expression — are ordinarily impermissible even if they are "completely free of content or 'viewpoint discrimination.'" *City of Ladue v. Gilleo*, 114 S. Ct. 2038, 2045 (1994) (invalidating ordinance that banned residential signs).

In addition, § 533(b) is subject to strict scrutiny for the separate reason that it *is* content-based. Section 533(b) "requires reference to the content of the relevant message in order to determine whether a particular visual image qualifies under the statutory definition of video programming," Pet. App. 84a — *i.e.*, "programming provided by, or generally considered comparable to programming provided by, a television broadcast station." 47 U.S.C. § 522(19). "[B]y any commonsense understanding of the term, the ban in this case is 'content-based.'" *City of Cincinnati v. Discovery Network, Inc.*, 113 S. Ct. 1505, 1516-17 (1993). Indeed, the definition of "video programming" is so inherently subjective as to amount to a "know-it-when-we-see-it" standard. It vests an administrative agency, the FCC, with impermissibly broad power over speech.

II. Even if strict scrutiny did not apply, § 533(b) could not survive intermediate scrutiny because it is not narrowly tailored to any significant governmental interest. *Every* expert telecommunications agency has concluded that § 533(b) is affirmatively *anti-competitive* and that existing regulatory safeguards could be adapted to serve any governmental purpose supposedly fostered by § 533(b). It is thus impossible for the Government to meet its burden of "demonstrat[ing] that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way." *Turner*, 114 S. Ct. at 2470.

The Government contends that § 533(b) prevents telephone companies from attempting to increase their profits by improperly shifting costs from video programming activities to regulated telephone service. But the undisputed record is that there is no risk of cost shifting in the absence of common costs, and that there are no common costs between the provision of video programming and the operation of the telephone network. If the problem of potential cost misallocation exists at all, it exists with respect to video transport, *which § 533(b) does not prohibit.* Moreover, every expert telecommunications agency has determined that existing regulatory safeguards are fully adequate to address any danger of cross-subsidy. The FCC's response to any difficulties in applying these rules has been to err on the side of *overcompensating* against any cross-subsidy risk. Accordingly, even if the cross-subsidy concern were valid, § 533(b) prohibits far more speech than is necessary to achieve the Government's purposes.

The Government also asserts an interest in preventing telephone company discrimination against cable companies in providing access to poles and conduit. But regulators have long disregarded this as a serious concern because cable networks are already fully deployed and accessible to 98% of the television households in the United States. The Pole Attachment Act ensures fair and reasonable rates. If, for some reason, the Act is not entirely up to the task, it can be amended or new regulations can be promulgated.

In the end, the Solicitor General is forced to fall back to the hypothesis that Congress might have concluded that § 533(b) is needed as a prophylactic measure to avoid the complexities and inconveniences of more narrowly targeted regulation. But Congress has made *no* findings in support of § 533(b), either in 1984 or in

the ensuing years. The only formal actions taken have been the recent votes by each House to repeal § 533(b).

More fundamentally, the Government's entire argument is foreclosed by elementary principles of narrow tailoring. The Government is not entitled to silence speech for the sake of convenience or as added insurance supposedly to *guarantee* that its interests are met. *Edenfield v. Fane*, 113 S. Ct. 1792, 1802-04 (1993); *Schneider v. State of New Jersey*, 308 U S. 147, 164-65 (1939). If the Government is concerned about discrimination, it can ban discrimination. If it is concerned about cross-subsidy, it can ban that. But in neither event may it simply ban speech.

In addition, § 533(b) fails intermediate scrutiny because it does not leave open adequate alternative avenues of expression. Section 533(b) has no more constitutional validity than a law prohibiting the *Washington Post* from publishing a newspaper but leaving it free to communicate through handbills, magazines, books, and billboards. Each of the Solicitor General's proffered alternatives is wholly inadequate. For example, he proposes that telephone companies might create programming and offer it to other, independent companies, such as local broadcasters or cable companies, who might or might not choose to distribute it to the public. But the denial of the telephone companies' editorial freedom can hardly be overcome by subjecting them to the editorial discretion of others.

III. The FCC's *Third Report and Order* cannot save § 533(b). That Order is nothing more than a statement of the FCC's unilateral intent, subject to change at any time in the Commission's discretion, to permit telephone companies to provide video programming under certain "terms and conditions" still to be devised by the Commission. Supp. Br. App. 6a n.11, 13a-14a. The *Third Report and Order* is in effect a promise voluntarily to cease the challenged conduct — a promise the FCC has twice breached by banning telephone companies from providing video programming over their networks despite outstanding federal court orders enjoining enforcement of the ban. The *Third Report and Order* provides no reason for this Court to refrain from holding § 533(b) unconstitutional.

Moreover, petitioners' "saving construction" is not a serious one. It contradicts the sole authoritative judicial interpretation of

§ 533(b)(4), as well as the prior determinations of the FCC. Furthermore, far from "saving" the statute, the construction would *exacerbate* the constitutional defect in § 533(b), by giving the Commission impermissibly broad licensing power over telephone company speech. And the construction would require this Court to decide the difficult constitutional question of whether telephone companies can be required to provide video programming exclusively through common carrier video transport systems, known as "video dialtone."

ARGUMENT

I. SECTION 533(b) IS INVALID UNDER STRICT SCRUTINY

Section 533(b) is subject to invalidation under strict scrutiny for at least two independent reasons.

A. SECTION 533(b) IS A DIRECT BAN ON SPEECH ITSELF, NOT A RESTRICTION ON CONDUCT, OR ON THE "TIME, PLACE OR MANNER" OF SPEECH

1. Section 533(b) bans telephone companies from providing, directly to their subscribers, video programming of the companies' own creation, selection, or arrangement. It "prohibits a common carrier from selecting or providing the video programming to be offered over a cable system" in the telephone company's service area. H.R. Rep. No. 934, 98th Cong., 2d Sess. 57 (1984). Certainly, therefore, § 533(b) bears no resemblance to a restriction on "conduct" that has merely an "incidental" effect on speech when applied to an expressive instance of that conduct. *United States v. O'Brien*, 391 U.S. 367, 376 (1968).

Rather, § 533(b) is a direct ban on speech and nothing but speech. As the District Court observed, "[t]he telephone company only runs afoul of the statute by exercising control or discretion over the programming transported . . . ." Pet. App. 102a; *see also id.* at 15a n.10 (§ 533(b) is a ban on "the provision, with editorial

control, of cable television services") (emphasis omitted). Section 533(b) targets the very acts of expression that this Court has identified as warranting First Amendment protection in the cable context. *See Turner*, 114 S. Ct. at 2456. Accordingly, § 533(b) is infirm for the same reason that the ban on editorial control over parades was unconstitutional in *Hurley v. Irish-American Gay, Lesbian and Bisexual Group of Boston*, 115 S. Ct. 2338 (1995). In fact, in *Hurley* this Court drew an explicit parallel to the very kind of editorial discretion that § 533(b) bans telephone companies from exercising. *See* 115 S. Ct. at 2345 ("Cable operators, for example, are engaged in protected speech activities even when they only select programming originally produced by others.").

Strict scrutiny is not limited to bans on speech that are based on the viewpoint, subject, or other "content" of the message being communicated. *See, e.g., Simon & Schuster v. New York Crime Victims Bd.*, 502 U.S. 105, 126 (1991) (Kennedy, J., concurring in judgment). Rather, strict scrutiny extends as well to bans like § 533(b) that tell speakers (especially a select *set* of speakers, *see City of Lakewood v. Plain Dealer Pub. Co.*, 486 U.S. 750, 763 (1988)), even in a content-neutral way, that they may not provide, at any time or place, speech to the audience and in the manner of their choosing. *See, e.g., Schad v. Borough of Mount Ephraim*, 452 U.S. 61, 75-76 (1981) (no live entertainment); *Buckley v. Valeo*, 424 U.S. 1, 15, 16, 17, 39, 44 (1976) (*per curiam*) (limits on political expenditures); *Martin v. City of Struthers*, 319 U.S. 141, 145-49 (1943) (limits on distributing literature door-to-door).

2. Section 533(b) is readily distinguishable from the cross-ownership rules cited by petitioners (Govt. Br. 3 n.2, 25 n.15; NCTA Br. 13 n.12, 46-48), for it is a ban on speech that does not even address the issue of ownership or control. "Cross-ownership" rules prevent an entity from owning two distinct media properties side by side. A TV broadcast station owning a newspaper in the same community is engaged in cross-ownership. *See* 47 C.F.R. § 73.3555(d) (1994). Section 533(b) does not prohibit telephone companies from constructing, buying, or *owning* cable systems *even within their own telephone service areas* — so long as an independent entity selects and arranges the video programming that

is provided to viewers.[9] In the District of Columbia, for example, Bell Atlantic owns the cable system and leases it to an unaffiliated company which provides the programming. JA 207-08.[10]

Section 533(b) is instead a rule that prohibits a speaker from using even its own facilities to provide speech of its own choosing. It would be, for example, as if the Manchester *Union Leader* were permitted physically to print and distribute newspapers, but banned from having its writers compose articles and its own editors select and arrange particular stories for publication.

3. This Court has consistently held that laws like § 533(b), which substantially foreclose an "important and distinct" medium of expression, cannot properly be characterized as "time, place, or manner" rules. *City of Ladue v. Gilleo*, 114 S. Ct. at 2045. Moreover, this Court has always distinguished between "a reasonable restriction on the manner" of speech and "a direct regulation of . . . speech itself." *Edenfield*, 113 S. Ct. at 1801. Section 533(b) plainly falls into the latter category. True time, place, and manner rules do not interfere with a speaker's ability to communicate the same speech to that speaker's chosen audience. *Ward v. Rock Against Racism, Inc.*, 491 U.S. 781, 802 (1989).

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[9] H.R. Rep. No. 934 at 57 (§ 533(b) does not "prevent a common carrier from constructing . . . a local distribution system that is capable of delivering video programming . . . [or] from leasing . . . such a system to a . . . cable operator"); *Video Dialtone Order*, 7 FCC Rcd at ¶ 111 (telephone companies are not barred "from acquiring existing cable facilities and leasing the physical plant to the franchised cable service provider").

[10] The cross-ownership rules cited by petitioners, together with *FCC v. National Citizens Comm. for Broadcasting*, 436 U.S. 775 (1978) ("*NCCB*"), are also inapposite because they relate to the specialized broadcast context governed by *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367 (1969), as this Court — and every lower court to consider § 533(b) — has recognized. *See Turner*, 114 S. Ct. at 2456-57; Pet. App. 21a-22a, 73a-74a; *U S West*, 48 F.3d at 1098; *BellSouth*, 868 F. Supp. at 1339; *Ameritech*, 867 F. Supp. at 729-31. *NCCB* reflects the power of government, in the "unique" medium of broadcasting, *Turner*, 114 S. Ct. at 2457; *Red Lion*, 395 U.S. at 367, to deny broadcast licenses to local newspapers. This special power has no application in this case. Indeed, *NCCB* explained that "the broadcast media pose unique and special problems not present in the traditional free speech case." 436 U.S. at 799 (internal quotations omitted).

The FCC has described § 533(b) as an "absolute ban" that "prohibits [telephone companies] from choosing the video programming to be provided in their local exchange telephone service areas *altogether*." Supp. Br. App. 3a, 4a (emphasis in original). Indeed, the practical effect of § 533(b) is to exclude telephone companies from what is indisputably "the most important mass medium in America." JA 142. The average television household watches television seven hours per day, whereas the average U.S. resident spends less than half an hour per day reading a newspaper. JA 196. The Government itself has recognized that the "'power to communicate ideas through sound and visual images . . . is significantly different from traditional avenues of communication because of the immediacy of the medium.'" *Telecommunications Research & Action Center v. FCC*, 801 F.2d 501, 508 (D.C. Cir. 1986) (quoting FCC), *cert. denied*, 482 U.S. 919 (1987).

Nor can § 533(b) be saved from strict scrutiny simply because it does not prohibit *every conceivable means* of communication potentially available to telephone companies. In *Ladue*, for example, this Court invalidated a law banning homeowners from posting signs even though it did not prevent them from "taking out a newspaper advertisement, handing out leaflets on the street . . ., standing in front of [a] house with a handheld sign," or even displaying flags with written messages. 114 S. Ct. at 2045, 2046 & n.16; *see also Lovell v. Griffin*, 303 U.S. 444, 451 (1938) (limit on distribution of literature is "no restriction . . . with respect to time or place"). Indeed, if § 533(b) could be deemed a "manner" restriction, then any ban on speech could be similarly described, so long as it left open some *possible* means of expression — whether soapbox oratory, purchase of a television station, or any of the other alternatives posited by petitioners in this case.

And § 533(b) is surely not a "place" restriction, despite its geographical reference, because it would permit telephone companies to provide video speech only in an entirely different region of the country — *i.e., to an entirely different audience*. "[O]ne is not to have the exercise of his liberty of expression in appropriate places abridged on the plea that it may be exercised in some other place." *Schneider*, 308 U.S. at 163 (ban on leafletting

in public streets invalid even though it left "persons free to distribute printed matter in other public places").

B. SECTION 533(b) IS CONTENT-BASED

1. Section 533(b) also triggers strict scrutiny for the independent reason that it is content-based. It prohibits telephone companies from providing their subscribers with "video programming," defined as "programming provided by, or generally considered comparable to programming provided by, a television broadcast station." 47 U.S.C. § 522(19). For example, a telephone company may offer stock market quotes, but not *Wall Street Week in Review*; on-line airline guides, but not a show about travel; educational multimedia presentations combining text, sound, and video, but not *Sesame Street*. *Video Dialtone Order*, 7 FCC Rcd at ¶¶ 76, 77 & n.196.

This statutory line has nothing to do with "the mode of delivery of the speech" (Govt. Br. 21) — in all of the examples, the speech would be delivered via the telephone network. Rather, the line is drawn according to the expressive attributes of the content of the speech: whether it is "generally considered comparable to programming provided by a television broadcast station" in 1984. *Video Dialtone Order*, 7 FCC Rcd at 5820; JA 363-64.

2. "[B]y any commonsense understanding of the term, the ban in this case is 'content-based.'" *Discovery Network*, 113 S. Ct. at 1513, 1516-17 (distinction between "commercial handbills" and "newspapers" is content-based, even though "[t]here is no doubt a 'common sense' basis for distinguishing between the two"); *see also Burson v. Freeman*, 504 U.S. 191, 207 (1992); *FCC v. League of Women Voters*, 468 U.S. 364, 383 (1984). Indeed, the Government concedes that a law distinguishing among "commercial or noncommercial, independent or network-affiliated, English or Spanish language" programming *would be* content-based. Govt. Br. 19 (quoting *Turner*, 114 S. Ct. at 2460). In no sense can a law singling out programming on the basis of whether it is "generally considered comparable to" 1984 television programming be deemed "content-neutral."

3. The Government's attempts to shield § 533(b) from strict scrutiny misconstrue settled First Amendment jurisprudence. For example, the Government insists that § 533(b) is not content-based because it supposedly "is not motivated by hostility to any message." Govt. Br. 20. But the motive of the legislature is irrelevant in determining the applicable level of scrutiny for a law that *by its very terms* discriminates on the basis of content. *Turner*, 114 S. Ct. at 2459 ("the mere assertion of a content-neutral purpose [will not] be enough to save a law which, on its face, discriminates based on content"). The Government suggests that § 533(b) should be less than strictly scrutinized because it is viewpoint-neutral. Govt. Br. 22. But it is axiomatic that viewpoint neutrality is not the same as content neutrality. *E.g.*, *McIntyre v. Ohio Elections Comm'n*, 115 S. Ct. 1511, 1518 (1995) (striking down a ban on anonymous leafletting that "applie[d] evenhandedly to advocates of differing viewpoints, [because it was] a direct regulation of the content of speech"); *Burson*, 504 U.S. at 197; *Arkansas Writers' Project, Inc. v. Ragland*, 481 U.S. 221, 229-30 (1987).

The Government also maintains that § 533(b) should be exempt from strict scrutiny because it can be *justified* without reference to the content of speech. But this Court has never indicated that a law which is content-based *on its face* can escape strict scrutiny because the Government's litigators can, with enough ingenuity, formulate a content-neutral rationale for it. If the contrary were true, almost any content-based law could avoid strict scrutiny.

4. Section 533(b) is also invalid because it vests an administrative agency with impermissible discretion over speech. The Government concedes that "instances may arise in which it will be difficult to determine whether a certain series of video images is 'comparable to' television broadcasting." Govt. Br. 22. The FCC has explained, for example, that interactive video programs "generally" fall outside § 533(b)'s prohibition, but "the mere inclusion of *some* interactive capability" would not take programming outside the ban. *Video Dialtone Order*, 7 FCC Rcd at 5821 & 5822 n.195 (emphasis added). In addition, according to the FCC, an "educational multimedia presentation which may contain video images" is not covered by § 533(b), but "the simple inclusion of *some* textual information" in a video program does not

make it a permissible multimedia presentation. *Id.* at 5822 n.196 (emphasis added). "[T]he Commission will allow telephone companies to transmit presentations that are *primarily textual*, and include *some* video segments, but will prohibit presentations that are *primarily video*, and include *some* textual segments." Pet. App. 87a (emphasis added).

It is not surprising that the Court of Appeals — even though it considered the statute content-neutral — nonetheless found this scheme constitutionally suspect. Pet. App. 29a n.22. The line between the permissible and the forbidden is far too subjective — like a statute leaving to an administrator the task of banning paintings "comparable" to those of Monet. The problem is not of the FCC's making; rather, the "know-it-when-we-see-it" quality of the *statutory definition* of video programming vests the FCC with the power and duty to "apprais[e] facts, . . . exercise . . . judgment, and . . . form[] an opinion," creating an intolerable "danger of censorship and abridgement of our precious First Amendment freedoms." *Forsyth County v. Nationalist Movement*, 112 S. Ct. 2395, 2401-02 (1992) (citations omitted); *see also City of Lakewood*, 486 U.S. at 757 ("the mere existence of the licensor's unfettered discretion, coupled with the power of prior restraint, intimidates parties into censoring their own speech, even if the discretion and power are never actually abused"); *Niemotko v. State of Maryland*, 340 U.S. 268, 272 (1951) ("custom" and "practice" insufficient restraint on discretion where "[n]o standards appear anywhere").

II. SECTION 533(b) CANNOT BE UPHELD EVEN UNDER "TIME, PLACE, OR MANNER" SCRUTINY

The Government contends that § 533(b) is a content-neutral "time, place, or manner" restriction that may be upheld under "intermediate scrutiny" so long as it (1) is "narrowly tailored to serve a significant governmental interest," and (2) "leave[s] open ample alternative channels for communication of the information," *Ward*, 491 U.S. at 791. But § 533(b) fails both prongs of this test. Its flat ban on video programming restricts far more speech than necessary to achieve any legitimate governmental interest, and none

of the alternative channels of communication that it leaves open is an adequate substitute for the video programming that it proscribes.

A. SECTION 533(b) IS NOT NARROWLY TAILORED TO SERVE A SIGNIFICANT GOVERNMENTAL INTEREST

Under the "narrow tailoring" requirement, the Government must demonstrate "that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way." *Turner*, 114 S. Ct. at 2470 (plurality opinion). Although a regulation need not be "the least speech-restrictive means" available, the Government must show that "the means chosen do not 'burden substantially more speech than is necessary to further the government's legitimate interests.'" *Id.* at 2469 (quoting *Ward*, 491 U.S. at 799).

That inquiry is particularly searching in the case of "preventative rules," like § 533(b), that impose "comprehensive bans" on entire categories of speech. *Edenfield*, 113 S. Ct. at 1802, 1803. As the Court has explained: "'Broad prophylactic rules in the area of free expression are suspect. Precision of regulation must be the touchstone in an area so closely touching our most precious freedoms.'" *Id.* at 1803-04 (quoting *NAACP v. Button*, 371 U.S. 415, 438 (1963)).

By its very nature, a prohibition on speech designed to prevent collateral harms — such as a ban on leafletting to prevent littering (*Schneider*, 308 U.S. 147), or a limitation on charitable fundraising to prevent *fraudulent* fundraising (*Village of Schaumburg v. Citizens for a Better Environment*, 444 U.S. 620 (1980)), or a ban on soliciting to prevent *unwanted* door-to-door soliciting (*Martin v. City of Struthers*, 319 U.S. 141 (1943)) — risks burdening First Amendment freedoms to a greater degree than necessary to achieve the Government's lawful purpose. Thus, "[i]f the government wants to avoid littering, it may ban littering, but it may not ban all leafleting. If the government wants to avoid fraudulent political fundraising, it may bar the fraud, but it may not in the process prohibit legitimate fundraising. If the government wants to protect householders from unwanted solicitors, it may enforce 'No

Soliciting' signs that the householders put up, but it may not cut off access to homes whose residents are willing to hear what the solicitors have to say." *Turner*, 114 S. Ct. at 2479 (O'Connor, J., concurring in part and dissenting in part) (internal quotations and citations omitted).

Section 533(b) suffers from the same constitutional infirmity. It bans video programming by telephone companies, not because much (or, indeed, *any*) of the speech thereby proscribed is itself harmful or undeserving of First Amendment protection, but assertedly because allowing a telephone company to provide such speech will encourage it to engage in anticompetitive "cross-subsidization" and "discrimination" to the detriment of telephone and cable consumers.

As we explain below, however, the Solicitor General has utterly failed to justify this sweeping prophylactic rule. The anticompetitive harms that he hypothesizes are rooted impermissibly in speculation and conjecture, not in the hard evidence that this Court's precedents require. The hard evidence is that 25 years of excluding telephone companies from providing video programming have produced cable monopolies in 99 percent of markets nationwide. Accordingly, every relevant governmental agency has concluded that the ban actually *disserves* the Government's purported objectives. But even if that threshold hurdle could be surmounted, the Solicitor General has not come close to justifying a flat ban on speech itself in preference to a direct ban on the feared anticompetitive conduct.

The most that the Solicitor General can say is that outlawing video programming is a "simpler" way to achieve the Government's objectives. Govt. Br. 31. But the Government can *always* say that. On the Solicitor General's theory, "comprehensive bans" on speech "would be permitted as a matter of course," *Edenfield*, 113 S. Ct. at 1803, a result altogether out of harmony with this Court's First Amendment precedents. It is no doubt "simpler" to outlaw leafletting than to enforce a law against littering, and more efficient to bar all household soliciting than to enforce a law prohibiting unwanted soliciting. But this Court repeatedly has ruled "simply and emphatically that the First Amendment does not permit the State to sacrifice speech for

efficiency." *Riley v. National Fed'n of the Blind*, 487 U.S. 781, 795 (1988) (citing *Schneider*, 308 U.S. at 147 and *Schaumburg*, 444 U.S. at 620). That principle is fatal to § 533(b).

1. The Government's Interest in Preventing Cross-Subsidy Cannot Justify a Ban on Video Programming

The Solicitor General argues that § 533(b) furthers the Government's "significant" interest in preventing "cross-subsidy." If telephone companies were free to provide video programming within their telephone service areas, the argument goes, they "would have an incentive to allocate the costs of their cable services to their monopoly telephone operations, and to have regulators set higher telephone rates based on those shifted costs." Govt. Br. 3. Having thus fooled the regulators, telephone companies could then effectively "subsidize their affiliated cable entities with monopoly telephone profits," thereby unduly burdening telephone ratepayers and subjecting cable competitors to unfair competition, all to the detriment of consumers. *Id.*

It is important to understand what "cross-subsidy" means in this context. A cross-subsidy can occur only if a cost-plus, rate-of-return regulated company is able to increase the profits from its regulated business by misallocating costs from an unregulated, competitive business to its regulated business. When cost-plus recovery is guaranteed, the more costs the better. Such a scheme can occur, however, only when there are costs in common between the regulated and unregulated businesses that can be shifted.

Given this background, the Solicitor General's effort to square § 533(b) with this regulatory concern is riddled with logical flaws.

a. The first problem with the Solicitor General's cross-subsidy theory is that § 533(b) is simply irrelevant to this regulatory issue. The statute does not ban the improper allocation of costs from unregulated to regulated services. It does not even address an activity that has common costs with telephone service. As both courts below properly found, Pet. App. 42a-43a, 101a-102a, what § 533(b) actually bans — the provision, with editorial control, of video programming by telephone companies — has *no* common

costs with telephone service. JA 274-75.[11] Conversely, § 533(b) leaves telephone companies entirely free to *transport* video signals generated and arranged by others, a service that *does* have common costs with telephone service.[12]

There is thus a complete mismatch between § 533(b) and the Government's supposed interest in preventing cross-subsidy. It is as if the State in *Schneider* had sought to prevent litter, not by banning littering, or even by banning the distribution of readily disposable leaflets, but by banning instead the distribution of any leaflets *containing the distributor's own message*. Just as the identity of a leaflet's author has nothing to do with the risk of litter, the identity of the video programmer whose signals are transmitted over a telephone company's facilitites has no link to any risk of cross-subsidy.

b. Petitioners speculate that a ban on video programming "removes the incentive" for telephone companies to engage in improper cost-shifting. Govt. Br. 25. According to petitioners, telephone companies already have the *power* to "cross-subsidize their video transport facilities," but their *incentive* to do so "would be greatly enhanced" if they were allowed to provide video programming, because that "would increase the value to the phone company of monopolizing transport." *Id.* at 26-27 (internal quotations omitted).

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[11] NCTA's own expert concedes that there are no common costs between telephone service and anything that § 533(b) actually prohibits. *See* JA 243. Thus, as NCTA has acknowledged, "opportunities for cross-subsidization may be few in the creation of programming." NCTA Mem. at 23, *United States v. Western Elec. Co.* (D.D.C. filed Oct. 17, 1990).

[12] It was stipulated below that, as a result of rapidly advancing technology, telephone companies (as well as cable companies) increasingly can transmit voice, data, and video signals over common network facilities. JA 195-96, 201-02; *see also* JA 138-41. "This kind of joint or common use is not an evil in itself: on the contrary, it is a source of efficiency — a clear exemplification of what economists refer to as economies of scope." JA 273 (affidavit of Prof. Alfred E. Kahn). Even under traditional rate-of-return regulation, the resulting economies will *benefit*, not harm, telephone ratepayers, so long as any joint costs of a common facility are allocated to video services.

As a threshold matter, petitioners' convoluted speculation about incentives is precisely the kind of "conjectural harm" that this Court rejected in *Turner*, 114 S. Ct. at 2470. As the Court of Appeals observed, "the FCC's contemporaneous discussions of its rule do not even hint at the complex of incentives and evils . . . involving the cable transport and video programming markets." Pet. App. 47a.

Even taken on its own terms, petitioners' argument is wrong. First, the goal of the cross-subsidizing firm is to increase its profits. If telephone companies actually could cross-subsidize video transport service without sacrificing overall profits, they would be doing that *now*. Money is money. Whether video programming is *more* profitable than video transport is beside the point, for the opportunities (if any) for cross-subsidy are limited to the joint costs associated with video transport.

The petitioners find themselves tripping over one another on this point. The Government asserts that, absent the ability to provide programming, a telephone company "has no incentive to drive cable companies out of business." Govt. Br. 27 (internal quotes omitted). But NCTA argues that "telephone companies have a uniquely strong incentive" to do so *now* because of "the competitive threat that cable presents to the telephone business itself." NCTA Br. 9, 37 & n.31; *see also* JA 187-88.

Second, there is a further mismatch between § 533(b) and the Government's "incentive" argument: the statute is not, despite the Government's claims, a ban on telephone companies' "earning profits" (Govt. Br. 26) from cable television. In fact, § 533(b) *allows* a telephone company to construct or purchase a cable system, arrange for a third party to choose the programming the system will offer, and share in the profits of that cable system — through rental income, for example, or through a direct 5% ownership in the third party operator. 47 C.F.R. § 63.54(e). A telephone company in such circumstances has a strong financial interest in the continued profitability of the cable system, despite its inability to select the programming. Even if it held no ownership stake in the cable operator, and even if rent were not computed directly on the basis of the cable system's profits, the telephone company would understand that the more valuable the property, the

higher the rent it could charge. A telephone company need not be involved in the direct provision of video programming at all: It could simply charge unaffiliated video programmers monopoly rates for carriage. Pet. App. 44a n.30.

c. Petitioners' arguments about cross-subsidy rest on the further erroneous supposition that regulators would be powerless to *prevent* telephone companies from improperly shifting to their regulated telephone services the costs of their competitive video services. But the FCC already "has in place a comprehensive system of cost allocation rules and cost accounting safeguards designed to separate nonregulated service costs from regulated service costs." *Video Dialtone Order*, 7 FCC Rcd at ¶ 92.[13] The FCC's response to the assertedly "complex" task of allocating joint costs (Govt. Br. 31) has been to *overcompensate* by assigning to a telephone company's *non*regulated activities a share of common costs substantially in excess of the incremental costs of those services.[14] And the Commission has "recently strengthened these cost accounting safeguards in order to ensure that the Commission is able to prevent and detect abuses should they occur. . . . Based on [its] experience with such safeguards, [the FCC] continue[s] to believe that they constitute an effective means of preventing cross-subsidization between regulated and unregulated services." *Video Dialtone Order*, 7 FCC Rcd at ¶ 92.

Every other telecommunications agency agrees with the FCC. The NTIA has concluded that the FCC's rules "are extensive and effective in controlling cross-subsidy." *NTIA Infrastructure Report*

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[13] These rules (1) impose detailed cost allocation standards, (2) establish accounting procedures, audit requirements, and other implementation and enforcement mechanisms, (3) require carriers (with operating revenues in excess of $100 million) to obtain FCC approval of a detailed cost allocation manual, and (4) set rules for recording transactions between regulated telephone companies and their corporate affiliates. *See* Report and Order, *Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities*, 2 FCC Rcd 1298, 1299 & n.70 (1987).

[14] "Far from permitting cross-subsidization of competitive by monopoly services, regulators have typically handicapped telephone companies in the competitive markets — inefficiently so." JA 278.

at 23. The Department of Justice has determined that FCC rules should be sufficient protection against cross-subsidy. Ct. App. JA 2767. The courts have also repeatedly upheld the FCC's accounting safeguards as "reasonably designed" to prevent cross-subsidization. *Southwestern Bell Corp. v. FCC*, 896 F.2d 1378, 1379 (D.C. Cir. 1990); *see also United States v. Western Elec. Co.*, 993 F.2d 1572, 1580-81 (D.C. Cir.) ("the FCC has acted since the break-up to tighten its accounting rules, especially its treatment of joint costs"), *cert. denied*, 114 S. Ct. 487 (1993); *California v. FCC*, 39 F.3d 919, 926 (9th Cir. 1994) ("[W]ith the implementation of these measures, the FCC has demonstrated that the [telephone companies'] incentive and ability to cross-subsidize will be significantly reduced"), *cert. denied*, 115 S. Ct. 1427 (1995); *U S West*, 48 F.3d at 1105-06; *American Scholastic TV Programming Found. v. FCC*, 46 F.3d 1173, 1182 & n.8 (D.C. Cir. 1995); *BellSouth*, 868 F. Supp. at 1342-43; *Ameritech*, 867 F. Supp. at 734-36.[15]

d. The regulatory premises of petitioners' cross-subsidy argument are flawed for yet another reason. As petitioners admit, cross-subsidy is a theoretical danger only to the extent that a telephone company is subject to traditional cost-plus rate-of-return regulation, under which carriers are allowed to recoup their costs of providing service plus a reasonable return on investment. Govt. Br. 3, 26, 35; NCTA Br. 5, 8, 11 & n.9, 37 n.31, 38 n.35, 42 n.37. But the FCC and a majority of the States now regulate the rates of the largest telephone companies under "price cap" rules that break the traditional link between costs and rates. *See National Rural Telecom Ass'n v. FCC*, 988 F.2d 174, 178 (D.C. Cir. 1993). "Under price caps, a [telephone company's] rates are governed by factors outside of its control, such as the inflation index, rather than by direct costs. Thus, a [telephone company] would have little incentive to shift costs from nonregulated activities to regulated ones because it would not be able to increase regulated rates to

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[15] That regulators may still occasionally "find evidence of cost-shifting" (Govt. Br. 34 n.24) proves only that the existing rules are vigorously enforced, not that they are ineffective.

recapture those costs." *California v. FCC*, 39 F.3d at 926; *see also Western Electric Co.*, 993 F.2d at 1580.

As the FCC itself only recently reiterated, "our price cap rules prevent telephone companies from raising interstate telephone service rates to recover nonregulated cable television investments."[16] The Department of Justice likewise has acknowledged that, under price caps, "[a] regulated firm would be unable to evade constraints through cross-subsidization. . . ." Ct. App. JA 1748. And NCTA's own expert has admitted that a pure price cap arrangement that severs the relationship between rates and costs would "reduce or eliminate the incentive to shift costs to regulated services. . . ." JA 263.[17] The mere availability of such obvious less burdensome measures to satisfy the Government's interests demonstrates that the restriction on speech is not narrowly tailored — even if those measures have not yet been adopted. *E.g.*, *Rubin v. Coors Brewing Co.*, 115 S. Ct. 1585, 1593-94 (1995); *Discovery Network*, 113 S. Ct. at 1510 & n.13.

The alternative of price cap regulation also shows that any risk of cross-subsidy here would stem *not* from a telephone company's

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[16] Fourth Report and Order, ¶ 18, *Telephone Company-Cable Television Cross-Ownership Rules*, CC Dkt. No. 87-266, FCC 95-357 (Aug. 14, 1995). *See also* JA 350-51 (FCC Memorandum); *Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards*, 6 FCC Rcd 7571, 7577-78 (1991) ("the adoption of price cap regulation . . . constitutes an effective complement to cost allocation, reporting, and enforcement safeguards, to reduce . . . incentives to cross-subsidize"), *aff'd in relevant part and rev'd in part*, 39 F.3d 919 (9th Cir. 1994).

[17] In this Court, too, the NCTA concedes that if "pure" price caps were widely adopted § 533(b) would be "substantially overbroad." NCTA Br. 37 n.31. In fact, the FCC, in new price cap rules adopted in April 1995, gave telephone companies the option to select precisely such a "pure" price cap mechanism for interstate services. First Report and Order, ¶¶ 19, 220, *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, FCC 95-132 (Apr. 7, 1995). Most of the companies subject to price caps have chosen that option. Fourth Further Notice of Proposed Rulemaking, ¶ 8, *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, FCC 95-406 (Sept. 27, 1995). Over 15 States, including many of the largest such as Michigan, Illinois, Pennsylvania, Virginia, and Wisconsin, have adopted pure price caps for intrastate services.

entry into competitive services but from a regulator's decision to choose rate-of-return regulation rather than price caps.[18] It would be wholly antithetical to the First Amendment to allow the Government to justify a ban on speech as needed to protect against regulatory risks of its own creation.

2. The Government's Interest in Preventing Anticompetitive Discrimination Cannot Justify a Ban on Video Programming

a. The Solicitor General argues that § 533(b) "is necessary to prevent [telephone companies] from abusing their control over the poles and conduits essential to the operation of a cable system (as the FCC concluded in 1970)." Govt. Br. 35. In 1970, however, cable television service was accessible to fewer than 10% of all households, and there was no legislation governing rates for pole and conduit access. The FCC believed that the then-nascent cable industry would be jeopardized if telephone companies were free to enter that business. *See* Govt. Br. 5.

That concern has no current vitality. In the Pole Attachment Act of 1978, Congress authorized the FCC, together with state officials, to "regulate the rates, terms, and conditions for pole attachments." 47 U.S.C. § 224(b)(1). Cable industry representatives themselves testified, even then, "that *access* to utility poles does not in itself constitute a problem." S. Rep. No. 580, 95th Cong., 2d Sess. 16 (1978) (emphasis added). The FCC staff likewise concluded as long ago as 1981 that "[t]he problem of pole access does not by itself justify banning crossownership." JA 62. The cable industry has since matured into an entrenched monopoly

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[18] *See, e.g.*, JA 56 (FCC Staff Report) ("This rationale for a crossownership ban is dependent on the assumption [of] rate of return regulation . . . . If regulators ignore reported costs and set rates on other grounds . . . the incentive to shift costs would likewise vanish"); *id.* at 72, 76 (FCC Staff Report) ("Many problems of telephone behavior are caused by rate-of-return regulation . . . . [R]ate regulation gives telephone companies strong incentives to engage in cost-shifting."); *id.* at 278 (Reply Aff. of Alfred E. Kahn) ("the cross-subsidization [petitioners] predict is possible only to the extent a telephone company's services are subject to cost-based, rate-of-return regulation").

to which "some ninety-eight percent of American homes have access." *U S West*, 48 F.3d at 1102. And the FCC accordingly has concluded that the "necessary access to poles and conduit to permit the growth of the cable industry has generally occurred." *Notice of Proposed Rulemaking*, 3 FCC Rcd at 5854; *see also* NTIA Infrastructure Report at 233.

Even if there were some residual concern about the cable industry's access to poles and conduit, that certainly could not justify § 533(b). As the District Court correctly noted, Pet. App. 102a n.29, "there is no doubt" that the law could be strengthened to guarantee non-discriminatory access, either by legislation,[19] or by FCC regulation,[20] as the Department of Justice has in fact proposed (Ct. App. JA 548), without any suppression of speech.

b. The Solicitor General also argues that § 533(b) eliminates any incentive for telephone companies to discriminate against competing video programmers who want to provide their programming via the yet-to-be-upgraded telephone network. Govt. Br. 5, 36-37. But telephone companies do not control any essential facility that these programmers need. *Cable companies*, which have deployed their own completely separate transmission networks and are not dependent on the telephone network for delivering their programming to customers, currently monopolize delivery of all multichannel video programming. Telephone company provision of video programming would greatly *expand*, not reduce, opportunities for independent programmers to reach their audiences.[21] It is perverse for the Government to cite a hypothetical

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[19] *E.g.*, H.R. 1555, 104th Cong., 1st Sess. §§ 242(a)(6), 244(b)(6) (1995); S. 652, 104th Cong., 1st Sess. § 251(b)(5) (1995); S. 1200, 102d Cong., 1st Sess. § 656 (1991) (Ct. App. JA 3109); H.R. 2546, 102d Cong., 1st Sess. § 656 (1991) (Ct. App. JA 3343).

[20] *See* Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, *Telephone Company-Cable Television Cross-Ownership Rules*, 10 FCC Rcd 244, at ¶ 285 (proposing rule "to prevent LECs from denying cable systems reasonable access to their pole or conduit space for the purpose of preventing competition from these cable systems").

[21] *See, e.g.*, JA 342 (Department of Justice) (lifting ban "will create an alternative player with whom third parties can bargain to carry their

potential for abuse against unaffiliated programmers as a justification for § 533(b), when lifting the ban would give these very programmers a voice that cable incumbents have denied to them.[22]

3. Section 533(b) Cannot Be Justified on the Basis of the Government's Preference for Administrative Convenience or Its Version of Regulatory History

The Government argues that, even if it would be "*possible* to prevent" cross-subsidy and discrimination through regulatory safeguards that do not interfere with expression, Congress was entitled to choose the "simpler" approach of outlawing speech in order to avoid the "administrative" inconvenience of narrowly targeted measures. Govt. Br. 31, 37 (emphasis in original). But, under either intermediate *or* strict scrutiny, considerations of ease and efficiency cannot justify a comprehensive ban on speech. *Edenfield*, 113 S. Ct. at 1802-04; *Riley*, 487 U.S. at 795. When the Government anticipates harmful effects supposedly associated with speech, the "simpler" way to guard against those harms will *always* be a complete ban on the speech.

The Government insists that Congress at least had "substantial evidence" on which to base its "choice of a simpler" ban on speech in preference to more precisely targeted regulatory solutions. Govt. Br. 31, 32. But even if this were relevant, the three items to which the Government points — the history of the AT&T divestiture, a

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programming"); JA 324 (Affidavit of Robin Smith) ("independent producers . . . need and would welcome the development of new distribution channels and new program packagers").

[22] Even with respect to voice and data information services conveyed exclusively over the phone network, the Government has documented at length that "there is no substantial risk that a [telephone company] could impede competition through discrimination" against competing content providers. Ct. App. JA 2631, 2635; *see also* Ct. App. JA 2772 ("existing regulation effectively constrains [telephone company] discrimination"). The FCC has similarly found that existing regulations will "address any concerns . . . with respect to discriminatory access." Ct. App. JA 2627 (FCC Mem. as *Amicus Curiae, United States v. Western Electric Co., Inc.*, C.A. No. 82-0192, at 11 (D.D.C. filed Aug. 22, 1990)).

1981 FCC Staff Report, and two reports from the General Accounting Office — could not support the surmise that regulatory safeguards "have significant disadvantages." Govt. Br. 31.

First, although petitioners cite the AT&T divestiture some 29 times in their briefs, it actually proves the opposite of what they claim. As part of the 1982 consent decree that broke up the Bell System and spawned the seven independent Regional Bell Operating Companies,[23] the parties voluntarily agreed to include a prohibition on telephone company provision of "information services," including cable television and database services like LEXIS/NEXIS. "[T]here really was no record to speak of concerning AT&T's activities in the information services market. The parties agreed to the information services restriction as a precautionary measure in light of uncertainty about how the divestiture of AT&T would affect development of this embryonic market." *United States v. Western Electric Co.*, 900 F.2d 283, 307-08 (D.C. Cir.) (*per curiam*), *cert. denied*, 498 U.S. 911 (1990). The Government itself said a "nonconsensual ban" on such services "would raise serious First Amendment issues." Ct. App. JA 1936 n.175; Ct. App. JA 2917 n.273.

If the Government's professed concerns about anticompetitive risk in video programming had any force, they would apply *a fortiori* to voice and data information services, which are often conveyed exclusively via local telephone exchanges over which telephone companies supposedly exercise "bottleneck" control. Yet in 1987, the Government asked the decree court to *eliminate* the information services restriction, concluding that there was "no substantial possibility that a [Bell Company] could . . . impede competition," Ct. App. JA 1906, 1909, and "no factual basis for" objections that telephone companies "would engage in cross-subsidization." Ct. App. JA 2790. In its decision affirming the decree modification, the D.C. Circuit endorsed the Government's determinations (1) "that there was no substantial risk that removal of the [information services] ban would lessen competition"; (2)

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[23] *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd mem. sub nom. Maryland v. United States*, 460 U.S. 1001 (1983).

that "regulation would play a substantial role in minimizing any anticompetitive risks"; and (3) "that removal of the ban would benefit consumers by enhancing competition in information services." *United States v. Western Electric Co.*, 993 F.2d at 1578. In fact, the court found that the evidence supporting the Government's request was so strong "that any district court rejection of the proposed modification would have been reversible error," and any findings that "contradict[ed] the Department's conclusions [would have been] clearly erroneous." *Id.*

Second, petitioners rely heavily (Govt. Br. 7, 26, 31-32, 35, 36; NCTA Br. 8-9, 38, 42, 43) on a November 1981 staff report, *FCC Policy on Cable Ownership* (*"Staff Report"*) (reprinted at JA 31-78). But they exaggerate the report's conclusions. The report acknowledged the significant pro-competitive benefits of telephone company provision of cable service. JA 43-52. But it concluded that the cable service ban should "be retained for the time being," JA 42, because the Commission's regulatory apparatus was still undeveloped: no "mechanism currently exists to separate cable costs from telephone costs." JA 58. The staff also noted that "further development of competitive technology" may render the restriction "unnecessary." JA 64.[24]

Changes in technology, market conditions, and regulation have made the Staff Report's recommendation obsolete. In particular, the report pre-dated the FCC's development of its cost-allocation regulations. In 1988, the Commission itself expressly rejected any prior reliance on cross-subsidy concerns as having occurred before the Commission "devised accounting standards that would prevent cross-subsidization." Further Notice of Inquiry and Notice of Proposed Rulemaking, *Telephone Company-Cable Television Cross-Ownership Rules*, 3 FCC Rcd 5849, 5854 (1988). Not surprisingly, the conclusions of the Staff Report have subsequently

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[24] The Staff Report did not represent the Commission's official views. In fact, the only Commissioner to comment on the issue filed a separate statement decrying what he called the "regulatory insanity" of not permitting telephone companies to enter cable television markets immediately. JA 27-29. He described the justifications for the ban as "sheer fantasy" and the predictions of anticompetitive harm as "border[ing] on hallucination." *Id.* at 27.

been repudiated by the FCC, the Department of Justice, the NTIA, and every reviewing court to consider the issue.

Third, petitioners claim that two reports issued by the GAO confirm the danger of cross-subsidy when telephone companies provide competitive services. But the GAO concluded not that § 533(b) — or any restriction on telephone company activities — should be retained but merely that FCC audit staff levels should be increased and that more on-site audits should be conducted.[25] And the FCC has since addressed this concern by requiring telephone companies to hire independent auditors to conduct annual audits.[26] Thus, the GAO reports confirm, rather than refute, the efficacy of regulatory mechanisms substantially less speech-restrictive than the prohibition imposed by § 533(b).

4. No "Deference to Congress" Is Warranted

The Government admits that Congress made no relevant factual findings in adopting § 533(b). Govt. Br. 29. But the Government's brief is nonetheless littered with suppositions about what "Congress reasonably concluded," *id.* at 31, and the Government suggests that Congress has somehow made a "predictive judgment" about the value of § 533(b) "to which the courts owe substantial deference." *Id.* 32 n.21. This argument is untenable.

In *Turner Broadcasting Co.*, a plurality of this Court emphasized that, even when Congress makes "unusually detailed" factual findings that "are recited in the text of the Act itself," 114 S. Ct. at 2454, 2461, in a First Amendment case a reviewing court is obligated to exercise "independent judgment" to ensure that the

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[25] *See* JA 86 ("GAO recommends that FCC develop a strategy for providing greater oversight of telephone companies' cost allocations. The key to the strategy is FCC's commitment to allocate sufficient audit staffing and travel funds to permit added field audits."); JA 134 ("expanded coverage through additional on-site audits by FCC would give ratepayers and the Congress greater assurance that cross-subsidization is not occurring").

[26] *See Computer III Remand Proceedings*, 6 FCC Rcd 7571, 7582. The GAO has admitted that these independent audits "should help." JA 85.

Government has met its burden of justification under intermediate scrutiny. *Id.* at 2471. This case is a step removed from that context.

Here, Congress has never made *any* findings that § 533(b) is necessary to address the specific interests identified by the Solicitor General. In fact, the only evidence cited of the supposed "predictive judgment" made by Congress is taken from snippets of legislative history that *post-date* passage of the ban. For example, the Solicitor General points to a 1990 Senate Commerce Committee report stating that the Committee "'could not at the present time'" support repeal of § 533(b) but adding (in a passage that he does not quote, *see* Govt. Br. 34) that "[t]he Committee wants the expert agency, the FCC, to examine the question." S. Rep. No. 456, 101st Cong., 2d Sess. 9 (1990). The FCC undertook such an examination, concluded that § 533(b) impedes competition, and recommended that it be removed. And in recent months each House of Congress has overwhelmingly voted to *repeal* the ban on video programming, signalling profound disagreement with the very rationale advanced by the Solicitor General and the cable incumbents before this Court.

Petitioners also suggest that, in adopting the 1992 Cable Act, Congress made a deliberate decision not to lift § 533(b). But the very Senate report they cite reveals otherwise: "the [Commerce] Committee decided that the question of whether telephone companies should be permitted to play a greater role in the cable market should be considered separately [from the question of whether to re-regulate cable]. . . . The Committee will [continue] to examine these issues." S. Rep. No. 92, 102d Cong., 1st Sess. 18 (1991). Indeed, the available evidence suggests that the Committee mistakenly believed that telephone networks would not soon be technologically capable of transmitting video programming. *See* pp. 4-5, *supra*.

In short, there are no congressional "findings" to which this Court could defer. By contrast, every expert governmental agency has explained in painstaking detail that each of petitioners' claims is wrong, in analyses that the Solicitor General has elsewhere argued are "particularly appropriate to respect." Br. of Govt.

Respondents in *Turner*, No. 93-44 at 30 (urging deference to the FCC's "predictive judgment").

B. SECTION 533(b) IS INDEPENDENTLY INVALID BECAUSE IT FAILS TO LEAVE OPEN ADEQUATE ALTERNATIVE AVENUES OF COMMUNICATION

Section 533(b) cannot be viewed as a mere limitation on the "manner" of speech. *See* Part I-A, *supra*. But even if the statute did not foreclose an entire medium, it would still fail intermediate scrutiny because it does not leave telephone companies with adequate alternatives for delivering their video speech. *See Members of City Council v. Taxpayers for Vincent*, 466 U.S. 789, 812 (1984). The Court of Appeals properly invalidated § 533(b) on this independent ground. Pet. App. 49a-51a.

1. "The First Amendment protects [speakers'] right not only to advocate their cause but also to select what they believe to be the most effective means for doing so." *Meyer v. Grant*, 486 U.S. 414, 424 (1988). For example, in *Edenfield*, this Court invalidated under intermediate scrutiny a ban on in-person solicitation by accountants even though it allowed them to solicit by mail or advertisement. 113 S. Ct. at 1799-1801.[27] Here, petitioners' proffered alternatives are no more adequate as a substitute for direct provision of video programming over the telephone network than the opportunity to distribute handbills is an adequate alternative for operating the *New York Times*.

2. Petitioners nonetheless claim that § 533(b) leaves open other means for telephone companies to engage in video speech (Govt. Br. 23-24, 37-38), but their proffered alternatives fall into three flawed categories. First, petitioners argue that telephone companies could *create* programming and offer it to television

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[27] *See also International Soc'y for Krishna Consciousness v. Lee*, 112 S. Ct. 2711, 2723 (1992) (Kennedy, J., concurring in the judgment) ("the Port Authority's regulation allows no practical means for advocates and organizations to sell literature within . . . its airports"); *id.* at 2727 (Souter, J., concurring in the judgment in relevant part) ("A distribution of preaddressed envelopes is unlikely to be much of an alternative.").

stations, cable operators, and others, who would decide whether, when, and how it would be *shown*. This would leave telephone company speech subject to the editorial control of others, and is thus no alternative at all, any more than writing letters to the editor is an alternative for publishing a newspaper.

Second, petitioners claim that telephone companies could bid to buy one of the few broadcast stations in each local market, or compete with other speakers to lease one or two channels that might be available on some local cable systems under the leased access provisions of 47 U.S.C. § 532. *See* JA 284-85. But each of these alternatives would severely constrain the amount of speech telephone companies could deliver.[28] Absent § 533(b), telephone companies could provide not one or two channels of video programming, but hundreds or thousands. JA 169; Description of Broadband Technologies' FLX System at 1 (Oct. 1992) (attached to Def. Supp. Jt. App. Exh. 2 & 3 in Dist. Ct.) (single, hair-thin glass fiber could provide over 1,500 channels). And telephone companies could provide essentially unlimited amounts of video programming through interactive services like video on demand, which would allow consumers to select (and view at their leisure) shows and movies from video libraries with no inherent limits. JA 151-52, 169-70, 288-89. Thus, it was undisputed on the record below that these first two categories of "alternatives" would exclude 99% of the programming that Bell Atlantic would supply directly to consumers in the absence of § 533(b). JA 288.

Third, the Solicitor General now stresses an additional category of supposed alternatives using new and unproven services, such as wireless cable ("MMDS") or direct broadcast satellite ("DBS"). Neither of these alternatives is remotely adequate. In

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[28] In practice, leased access channels also remain subject to the editorial control of cable operators. JA 284, 289-90. Congress itself has concluded that "leased access has not been an effective mechanism for securing access for programmers to the cable infrastructure or to cable subscribers." H.R. Rep. No. 628, 102d Cong., 2nd Sess. 39 (1992); *see also* Donna N. Lampert, *Cable Television: Does Leased Access Mean Least Access?*, 44 FED. COMM. L.J. 245, 248 (Mar. 1992) ("the access provisions of the Cable Act have wholly failed to serve their intended purpose").

contrast to the existing telephone network, which reaches 100 million subscribers nationwide, DBS and MMDS have yet to achieve more than 1 percent of market penetration after more than two decades of development.[29] Moreover, both DBS and MMDS are broadcast technologies licensed by the government, and licenses are in short supply.[30]

In short, neither DBS nor MMDS is the kind of demonstrably adequate, "practical substitute[]" that intermediate scrutiny demands. *Ladue*, 114 S. Ct. at 2046; *Linmark Associates, Inc. v. Willingboro*, 431 U.S. 85, 93 (1977). Accordingly, § 533(b) is unconstitutional for the separate reason that it fails to leave open adequate alternative channels for communication.

III. THE FCC'S THIRD REPORT AND ORDER CANNOT "SAVE" SECTION 533(b)

Throughout this case, petitioners have advanced a series of procedural smokescreens to avoid a decision on the merits. In the District Court, the Government challenged Bell Atlantic's standing.

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[29] "[L]ess than 1 percent of . . . multichannel service consumers get their television from direct broadcast satellites." 141 Cong. Rec. S 8422 (June 15, 1995) (statement of Sen. Lieberman). DBS systems broadcast the same programming nationwide, with no opportunity to carry the local broadcast stations that still account for some two-thirds of audience viewing time (*1994 Competition Report* at ¶ 97), or to tailor programming to local audiences as Bell Atlantic proposes. JA 150, 172.

Similarly, "wireless cable has not achieved significant penetration nationwide," reaching only about half a million subscribers. *1994 Competition Report* at ¶ 79. Wireless cable transmitters must have line-of-sight access to customer homes in order to deliver programming. Consequently, many homes are unable to receive service from this technology because they are blocked by trees, hills, or buildings. According to the FCC, the average wireless cable operator has access to only 75 percent of the homes in its service area. *Id.* at ¶ 87.

[30] MMDS operators "have [had] difficulty in gaining access to a sufficient number of channels to provide competitive service," because holders of licenses have "warehoused" channels for future use. *1994 Competition Report* at ¶ 85. The FCC has been working on licensing DBS systems since 1980. Notice of Inquiry, *Direct Broadcast Satellites*, 45 Fed. Reg. 72719 (Nov. 3, 1980). To date, only three systems are operational.

Pet. App. 66a-69a. In its rehearing petition in the Court of Appeals, NCTA suggested that the court vacate its judgment in light of a supposedly new-found "saving construction" of the statute that in fact had been briefed and argued from the very beginning of the case.[31] On certiorari, petitioners urged this Court to vacate the Court of Appeals' judgment and remand the case in light of the FCC's reinterpretation of its "good-cause waiver" authority in the *Third Report and Order*. This Court declined to do so. 115 S. Ct. 2608 (1995).

There is no reason to take petitioners' "saving construction" more seriously at this stage.

1. The *Third Report and Order* is nothing more than a statement of the FCC's unilateral intent, subject to change at any time in the Commission's discretion, to permit telephone companies to provide video programming under certain circumstances and pursuant to unspecified "terms and conditions" still to be devised by the Commission. Supp. Br. App. 6a n.11, 13a-14a. As such, it provides no reason for this Court to refrain from holding § 533(b) unconstitutional.[32] Whether in the end the Commission will in fact adopt a "more speech-friendly" plan (Supp. Br. App. 3a) — or whether the terms will even be economically or technologically feasible — remains to be seen.

The history of the FCC's decisionmaking in this area is not reassuring. The FCC has been studying and proposing the

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[31] Petitioners repeat here the suggestion that the saving construction was not presented to the courts below. Govt. Br. 39; NCTA Br. 17, 27. If that were true, this Court should adhere to its usual prudential rule in federal cases of declining to decide issues not raised or resolved in the lower court. *E.g.*, *Taylor v. Freeland & Kronz*, 503 U.S. 638, 646 (1992). In fact, however, the saving construction was briefed in, and properly rejected by, the courts below. *See* Response to Petitions for Cert. at 16-20 (May 30, 1995).

[32] *See Northeastern Florida Contractors v. Jacksonville*, 113 S. Ct. 2297, 2301 (1993) ("a defendant's voluntary cessation of a challenged practice does not deprive a federal court of its power to determine the legality of the practice"); *City of Mesquite v. Aladdin's Castle, Inc.*, 455 U.S. 283, 289 (1982) (repeal of law does not prevent judicial review because repeal "would not preclude [the city] from reenacting precisely the same provision if the District Court's judgment were vacated").

elimination of § 533(b) since 1987.[33] But not until May 16, 1995 — nearly two years after the Commission was first enjoined from enforcing the ban and on the eve of the filing of the Solicitor General's petition for certiorari in this case — did the Commission suggest taking any action. In recently voting to repeal § 533(b), Members of Congress criticized the Commission for its tardiness.[34]

Indeed, the FCC has twice banned telephone companies from providing video programming over their networks despite outstanding federal court orders to the contrary.[35] If this Court overturns those orders, there will be nothing to stop the FCC from abandoning the *Third Report and Order* entirely, reinstating a narrow good-cause waiver policy, and resuming strict enforcement

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[33] In 1987, the FCC issued a Notice of Inquiry proposing re-examination of § 533(b). 2 FCC Rcd 5092, 5093 (1987). The next year, it issued a Further Notice of Inquiry and Notice of Proposed Rulemaking tentatively concluding that § 533(b) should be eliminated. 3 FCC Rcd 5849, 5851, 5865 (1989). After a four-year delay, the Commission formally reaffirmed that conclusion. *Video Dialtone Order*, 7 FCC Rcd at ¶¶ 135-43.

[34] *See, e.g.*, 141 Cong. Rec. S 7965 (June 8, 1995) (statement of Sen. Craig) ("It has taken more than 4 years for the FCC to create a general framework for video dial tone, and with each successive ruling more and more constraints have been placed on telephone companies wishing to offer cable TV services. That is not the way to foster competition. And it is not giving consumers the additional cable choices they have all asked for and they think in a free market they ought to be able to receive. In effect, the FCC 4-year delay has prevented robust competition in the cable industry.").

[35] Even though the FCC is bound by a district court order enjoining enforcement of § 533(b) — which it has never sought to stay — the FCC has denied Bell Atlantic the right to provide video programming over an approved video dialtone system in Dover Township, New Jersey. Order and Authorization, *Application of New Jersey Bell Tel. Co.*, 9 FCC Rcd 3677, 3690 (1994). Bell Atlantic asked the FCC to reconsider its decision as inconsistent with the injunction, but the request remains pending with the FCC more than a year later, *Petition of Bell Atlantic-New Jersey for Limited Reconsideration*, File No. W-P-C 6840 (Aug. 17, 1994), despite a statutory 90-day deadline for ruling on reconsideration requests. 47 U.S.C. § 405(b)(1). The Commission recently prohibited another telephone company from speaking on its video dialtone system, notwithstanding another federal court order to the contrary. *See* Memorandum Opinion and Order on Recon., at ¶ 8, *Application of Ameritech Operating Companies*, File Nos. W-P-C 6926, *et al.* (Oct. 6, 1995).

of what the FCC calls "the absolute ban contained in the statute." Supp. Br. App. 4a. The FCC issued its *Third Report and Order* only in reaction to judicial decisions holding § 533(b) unconstitutional. *Id.* at 6a-7a & n.13. In fact, the Commission's admitted goal was to "make it unnecessary for [the Supreme Court] to decide whether a complete prohibition on video programming by telephone companies in their exchange areas is constitutional." *Id.* at 7a. Unless this Court affirms the judgment below, a principal basis of the FCC's action would disappear. The Commission has warned telephone companies that, "[i]f the government prevails in the Supreme Court, we will have to conduct further proceedings to determine how best to bring the parties into compliance with the Court's judgment." Fourth Report and Order, at ¶ 25, *Telephone Company-Cable Television Cross-Ownership Rules*, CC Docket No. 87-266, FCC 95-357 (Aug. 14, 1995).

2. Petitioners' "saving construction" is in any event not a plausible interpretation of § 533(b). Although statutes are construed to avoid constitutional difficulties, "'avoidance of a difficulty will not be pressed to the point of disingenuous evasion.'" *Rust v. Sullivan*, 500 U.S. 173, 191 (1991) (quoting *George Moore Ice Cream Co. v. Rose*, 289 U.S. 373, 379 (1933)).

The *Third Report and Order* purports to change § 533(b) from what the Commission calls an "absolute ban," Supp. Br. App. 4a, to a restriction that the Commission can "routinely" waive at its option. *Id.* at 19a. Yet the statutory language of § 533(b)(4) indicates that waivers are available only on the basis of "the particular circumstances demonstrated by the petitioner."[36] Section

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[36] Section 533(b)(4) provides:

> In those areas where the provision of video programming directly to subscribers through a cable system demonstrably could not exist except through a cable system owned by, operated by, controlled by, or affiliated with the common carrier involved, or upon other showing of good cause, the Commission may, on petition for waiver, waive the applicability of paragraphs (1) and (2) of this subsection. Any such waiver shall be made in accordance with section 63.56 of title 47, Code of Federal Regulations (as in effect September 20, 1984) and shall be granted by the Commission upon a finding that the issuance of such waiver is justified by the particular

533(b)(4) also references "section 63.56 of title 47, Code of Federal Regulations (as in effect September 20, 1984)," which prescribes a series of procedures for case-by-case, fact-specific inquiries focusing on exceptional circumstances — a test that is inconsistent with the broad waiver standard now proposed by the FCC.[37] The Commission may not simply rewrite a section of the Communications Act. *MCI Telecommunications Corp. v. AT&T*, 114 S. Ct. 2223 (1994).

Not surprisingly, the *Third Report and Order* flies in the face of the only authoritative judicial interpretation of § 533(b)(4). In *National Cable Television Ass'n v. FCC*, 914 F.2d 285 (D.C. Cir. 1990), the Court of Appeals, at the urging of the NCTA, reversed a good-cause waiver granted by the Commission to a telephone company affiliate to participate in the operation of an experimental fiber-optic system in a single California community — a much more limited request than the sea change proposed by the *Third Report and Order*. The Court of Appeals disagreed that the Commission "enjoyed considerable latitude" in granting good cause waivers. *Id.* at 288. The court explained that "[t]he policy of the subsection, which the Commission must take into consideration, is to prohibit" telephone company video programming. *Id.* at 289. The court held that a waiver was unavailable absent a showing that telephone company participation was "necessary" to the construction or operation of a cable system. *Id.*

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circumstances demonstrated by the petitioner, taking into account the policy of this subsection.

[37] Indeed, that approach conflicts with the concept of "good cause waiver" as it is used throughout the U.S. Code. For example, an agency could not use the good cause exception for notice and comment procedures, 5 U.S.C. § 553, to decide that it will depart on a "routine" basis from Administrative Procedure Act requirements. *Buschmann v. Schweiker*, 676 F.2d 352, 357 (9th Cir. 1982) ("good cause" exception "is essentially an emergency procedure"). Nor could a U.S. Attorney's office use the "good cause" provision of the Speedy Trial Act to declare that it will "routinely" extend the 90-day period provided in 18 U.S.C. § 3161. *E.g.*, *Furlow v. United States*, 644 F.2d 764, 767 (9th Cir.), *cert. denied*, 454 U.S. 871 (1981) (Mt. St. Helen's eruption satisfied "good cause" requirement). *See also Kleem v. INS*, 479 U.S. 1308 (1986) (Scalia, Circuit Justice) (construing "good cause" rule of 28 U.S.C. § 2101(c)).

The *Third Report and Order* also contradicts the Commission's previous construction of its waiver authority. The FCC previously held that "it 'is the policy of this subsection [§ 533(b)] that telephone companies should be prohibited from providing video programming directly to subscribers in their telephone service areas. The waiver authority should be narrowly construed and exercised in a manner that does not undermine the basic policy of this subsection.'"[38] The *Third Report and Order* barely acknowledges this radical shift in the Commission's interpretation, let alone attempts to explain it, as the FCC was required to do.[39] For its part, the NCTA previously has argued for a limited view of § 533(b)(4).[40]

3. Even if valid, the construction is not a "saving" one. If anything, it *compounds* the constitutional infirmity in § 533(b) by vesting the Commission with impermissibly broad licensing power over telephone company speech. In fact, by illustrating how the FCC can dramatically expand and contract its waiver authority at will, the *Third Report and Order* underscores just how vast the Commission's discretion is. The Commission unilaterally promises that it will "routinely" grant waivers so long as "the telephone company agrees to abide by the regulations we will establish governing its provision of video programming." Supp. Br. App. 19a. But under the *Third Report and Order*, telephone company

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[38] *Telephone Company-Cable Television Cross Ownership Rules*, 3 FCC Rcd 5849, 5850 (1988) (quoting 130 Cong. Rec. H 10,444 (daily ed. Oct. 1, 1984)); *see also* 1970 Order at ¶ 11 (waiver policy "should be on a case-by-case basis, . . . rather than by any blanket exemption"); JA 43 n.7 (waiver standard imposes a "high burden"); Br. of Government in *Ameritech Corp. v. United States*, No. 95-1223, at 43 (7th Cir.) (filed Mar. 13, 1995) (admitting that the possible re-interpretation of § 533(b)(4) "would constitute a significant change in the agency's prior understanding of the statutory requirements").

[39] *See Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42 (1983); *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 212 (1988) (agency "litigating positions" not entitled to deference).

[40] *See, e.g.*, Br. of Petitioner in *NCTA v. FCC*, No. 89-1517, at 37 (D.C. Cir. filed Apr. 6, 1990) ("Congress has instructed that [the FCC's] waiver authority must be narrowly construed").

video speech will still be illegal until the Commission decides whether, when, and how to allow it. The Commission has the power to create, and to change, the still-to-be-developed terms and conditions for granting waivers, and there is no specified time within which the Commission is required to act on waiver applications.[41] It was stipulated in this case that waiver applications have languished for years before the Commission. *See* JA 204-05.[42]

Thus, the good-cause waiver authority is itself an open-ended grant of standardless licensing power, in violation of the fundamental principle that the government "cannot vest restraining control over the right to speak [in] an administrative official where there are no appropriate standards to guide his action." *Kunz v. New York*, 340 U.S. 290, 295 (1951).[43] For First Amendment

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[41] "[T]he failure to confine a time within which the licensor must make a decision contains the same vice as a statute delegating excessive administrative discretion." *FW/PBS, Inc. v. City of Dallas*, 493 U.S. 215, 226-27 (1990); *see also City of Lakewood*, 486 U.S. at 771; *Riley*, 487 U.S. at 802.

[42] Waiver applications contested by cable incumbents have taken as long as 1,113 days for the FCC to process. *Bentleyville Telephone Co., Petition for Waiver of Sections 63.54 and 63.55 of the Commission's Rules and Application for Authority to Construct and Operate a Cable Television System Within Its Telephone Service Area*, File No. W-P-C 6817 (May 16, 1995). Likewise, applications to deploy facilities for video dialtone service, which the Commission has held are an essential prerequisite to providing programming, have been substantially delayed. For example, one application is still pending after nearly three years. *Application of New Jersey Bell*, File No. W-P-C 6838 (filed Nov. 16, 1992). *See* 141 Cong. Rec. S 8193-94 (June 12, 1995) (statement of Sen. Kerrey) ("telephone companies saw their applications to offer [video dialtone] languish as agency officials insisted on changes in many plans. Today, only a handful of tiny experiments exist").

[43] The Government insists that this principle is inapplicable because the waiver supposedly will not be explicitly based "on the content of the speech." Govt. Br. 41. But the same could have been said in *City of Lakewood*, 486 U.S. at 755-59, 769-72, *FW/PBS, Inc.*, 493 U.S. at 225-26, *Riley*, 487 U.S. at 801-02, *Secretary of State of Maryland v. J.H. Munson Co.*, 467 U.S. 947, 964 n.12 968 (1984), *Shuttlesworth v. Birmingham*, 394 U.S. 147, 150-51 (1969), *Staub v. City of Baxley*, 355 U.S. 313, 321 (1958), *Saia v. New York*, 334 U.S. 558, 559-61 (1948), *Largent v. Texas*, 318 U.S. 418, 422 (1943), *Schneider*, 308 U.S. at 163-64, and *Lovell*, 303 U.S. at 451.

purposes, the waiver regime in the *Third Report and Order* is no different from a city's flat ban on holding rallies in a public park, accompanied by a promise from the police chief that "good cause" exceptions will be granted according to "speech-friendly" standards to be developed sometime in the future. The technology is different, but the principle is the same.

4. Moreover, far from *avoiding* constitutional issues, the construction raises grave *new* constitutional questions. Instead of permitting each telephone company to provide video programming *either* as a traditional (*i.e.*, non-common carrier) cable provider *or* as one of the programmers on a common carrier video dialtone system — as would the bills recently adopted by each House of Congress[44] — petitioners' "saving construction" would permit telephone companies to provide video speech *only* through video dialtone. Thus, the Government emphasizes that the FCC's waiver policy "requires a common carrier element." Govt. Br. 40.[45] Although some telephone companies might voluntarily choose a video dialtone system to provide video programming (as Bell Atlantic would do in Alexandria, Virginia, *see* JA 13, 214-15, 218), designating such a system as the only option for video speech itself raises grave constitutional questions.

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[44] The Government implies that the bills are limited to the video dialtone option, Govt. Br. 16 n.12, but that is incorrect. For example, H.R. 1555 provides that a telephone company may provide video programming either as a programmer on a video dialtone system or "as a cable service." H.R. 1555, 104th Cong., 1st Sess. § 201 (1995). *See* 141 Cong. Rec. E 1699 (Aug. 11, 1995) (remarks of Rep. Tauzin) (H.R. 1555 "gives all telephone companies the choice between entering video markets as Title II common carriers or as Title VI cable operators."); *see also* S. 652, 104th Cong., 1st Sess. § 202(a) (1995).

[45] Petitioners also attempt to defend the "saving construction" as preventing telephone companies from purchasing incumbent cable systems. Govt. Br. 42, NCTA Br. 31-32. But § 533(b) does not bar telephone companies from owning or buying cable systems. *See* pp. 13-14, *supra*. Moreover, Clayton Act § 7 already bars acquisitions where their effect "may be substantially to lessen competition or tend to create a monopoly." 15 U.S.C. § 18; *see also* JA 249-50. Petitioners have never disputed that "existing antitrust laws could be applied to prohibit telephone companies from acquiring cable companies within their telephone service areas." Respondents' Dist. Ct. Reply Br. 7 (June 5, 1993).

A mandatory common carrier scheme, even if efficiently administered, would dramatically raise the cost of telephone company video speech: If telephone companies wished to provide video programming, they would have to do so through a system that contains sufficient excess capacity to allow a substantial number of other speakers to communicate as well. They could not simply build enough capacity to allow *themselves* to speak.[46] The FCC has suggested that it may preclude a telephone company from speaking on as much as 75% of the capacity on its system. Supp. Br. App. 13a n.34; *Video Dialtone Order*, 7 FCC Rcd at ¶ 143 n.360. Such a draconian limit on the quantity of expression would be far worse even than the displacements of speech that were found invalid in *Hurley*, 115 S. Ct. at 2349-50 (addition of a small group to parade), *Pacific Gas & Elec. Co. v. Public Utilities Comm'n*, 475 U.S. 1, 17-18 (1986) (small insert in "extra space" of billing envelope), or *Miami Herald Pub. Co. v. Tornillo*, 418 U.S. 241, 256-57 (1974) (short reply in newspaper), or than the displacement of a potentially small number of cable channels by the must-carry rules in *Turner*, 114 S. Ct. at 2471-72; *see also* Br. of Govt. Respondents in *Turner*, No. 93-44 at 30 ("If the operators are right, . . . 98% of the broadcast stations that are entitled to be carried . . . would be carried in any event").

That a telephone company is a common carrier for purposes of voice transmissions does not mean that it may be forced to *speak* only as a common carrier.[47] And the FCC's requirement would

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[46] NCTA concedes that the FCC's waiver policy will be "distinctly objectionable" to those telephone companies that want to build only enough transport capacity to carry their own video speech. NCTA Br. 29 n.23.

[47] It is axiomatic that a telecommunications company "may operate as a common carrier with respect to a portion of its service only." *FCC v. Midwest Video Corp.*, 440 U.S. 689, 701 n.9 (1979); *see also National Ass'n of Regulatory Utility Comm'rs v. FCC*, 533 F.2d 601, 608 (D.C. Cir. 1976) ("Since it is clearly possible for a given entity to carry on many types of activities, it is at least logical to conclude that one can be a common carrier with regard to some activities but not others"); *Southwestern Bell Tel. Co. v. FCC*, 19 F.3d 1475, 1481, 1484 (D.C. Cir. 1994) (whether a service is a common carrier service turns not on telephone company's status overall, but on nature of "the particular practice under surveillance").

raise major Takings Clause concerns as well, for commandeering a portion of the telephone network for mandatory common carriage of video signals would seem to be an uncompensated electronic occupation of private property that is in principle indistinguishable from the law invalidated in *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982). *See also Midwest Video Corp. v. FCC*, 571 F.2d 1025, 1057 (8th Cir. 1978) (FCC rule requiring cable companies to build excess capacity and operate in part as a common carrier constituted a taking in violation of the Fifth Amendment), *aff'd on other grounds*, 440 U.S. 689 (1979).[48]

Neither the *Third Report and Order* nor petitioners' briefs confront any of these difficult questions. Hence, the proper disposition of this case is to hold § 533(b) facially invalid. If the Government believes that a different regulatory regime would be permissible, it is free to adopt that scheme and let its constitutionality be adjudicated in due course. But it cannot simply ban telephone company video speech in the interim.

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[48] *PruneYard Shopping Center v. Robins*, 447 U.S. 74 (1980), does not suggest a different result. "Notably absent from [*PruneYard*] was any concern that [the state law] might affect the shopping center owner's exercise of his own right to speak." *Pacific Gas & Elec. Co.*, 475 U.S. at 12; *see id.* at 23-24 (Marshall, J., concurring in judgment) ("While the shopping center owner in *PruneYard* wished to be free of unwanted expression, he nowhere alleged that his own expression was hindered in the slightest.").

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted.

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Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

Bell Atlantic agrees with our contention that this Court should grant the petition for certiorari from the judgment of the Fourth Circuit. It vigorously urges the Court, however, not to adopt the suggestion that, upon granting the petition, the Court remand the case to afford the Fourth Circuit the opportunity to give full consideration to an important development post-dating the court of appeals' decision: the Commission's adoption, by formal rulemaking, of a construction of Section 533(b) that transforms the terms of the question decided by the Fourth Circuit. While plenary review of the case at this stage certainly would be appropriate, Bell Atlantic has failed to show that a remand is not the more sensible and appropriate course.

There can be no doubt that the new Commission construction radically changes the issue actually decided by the court of appeals. In its central description of the Fourth Circuit's ruling, Bell Atlantic pinpoints the construction of Section 533(b) that formed the premise for the holding of invalidity: " '[t]he First Amendment problem with § 533(b) is that the provision does not allow the telephone companies to engage in protected speech, that is, the provision, with editorial control, of cable television services.' " Br. in Resp. 4, quoting 94-1893 Pet. App. 15a n.10 (emphasis deleted by respondents). *See also* Br. in Resp. 1 ("47 U.S.C. § 533(b) . . . bars local telephone companies from providing video programming directly to subscribers in their telephone service areas"). What the Commission decided in the recently completed rulemaking, however, was that Section 533(b) does not in fact have that effect. Under the Commission's construction of the whole of Section 533(b), including the waiver provision of paragraph (4), the statute *allows* local telephone companies "to engage in protected speech, that is, the provision, with editorial control, of cable television services" in their telephone service areas. The explicit premise of the Fourth Circuit's holding has been eliminated by the Commission's rulemaking since the time the Fourth Circuit ruled (and denied rehearing).[1]

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[1] Bell Atlantic overstates the effect of Section 533(b), even aside from paragraph (4), when it excerpts a quote from an affidavit and asserts that the statute "excludes telephone companies from what is undisputedly 'the most important mass medium in America.' " Br. in Resp. 9 (quoting Affidavit of William Lee, Ct. App. JA 141). What the quoted affidavit says, however, is that "*video communication* is the most important mass medium in America." (emphasis added). Bell Atlantic, which (among other things) has entered the wireless cable business and may become a broadcaster, plainly is not excluded from video communication, any more than are broadcasters (who likewise are subject to cable cross-ownership restrictions). *See* Pet. 9, 27.

A remand to the Fourth Circuit would allow the court to address this issue-altering development. It also would, consistent with this Court's normal certiorari policy, provide the benefit of at least one lower-court ruling on a question presented for decision—here, the essential threshold question of statutory construction. And the expenditure of this Court's resources may be rendered entirely unnecessary by the Fourth Circuit's action on remand or, possibly, by legislation replacing Section 533(b) that is now making its way through Congress.

Bell Atlantic intimates that a remand would be futile, pointing to several places in the parties' papers in the lower courts where Section 533(b)(4) was cited or discussed. Br. in Resp. 16-20. This suggestion takes an unrealistic view of the course of proceedings. The Fourth Circuit *could not* have considered the Commission's new formal rule on the proper construction of Section 533(b)(4), which was not even proposed until two days after the Fourth Circuit's last action in the case—denial of rehearing. Moreover, the Fourth Circuit was not presented with any developed argument for a "saving construction" of Section 533(b)(4) prior to its decision; never received *any* presentation on the issue from the Commission, the agency charged with administering the statute; and plainly misread Section 533(b)(4) in its only mention of the provision in its opinion. *See* Pet. 15-16, 22. The Fourth Circuit realistically would have something new and important to consider upon remand.

A remand in these circumstances would be in keeping with *Bureau of Economic Analysis v. Long*, 454 U.S. 934 (1981), where an "intervening Act of Congress changed the substantive law applied by the Court of Appeals." Br. in Resp. 13 n.16. The Commission's formal rulemaking, subsequent to the Fourth Circuit's decision and rehearing denial, effects an equivalent change in the applicable law under *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837

(1984).[2] A remand would also be consistent with this Court's actions remanding for reconsideration even when a change in statutory construction is advanced by the government simply as a litigant. *See, e.g., Knox v. United States*, 114 S. Ct. 375 (1993). Bell Atlantic identifies no case indicating that a remand would be inappropriate in the present circumstance. The issue is simply one of prudent administration in the ordering of judicial consideration of important legal issues on their merits.[3] A remand in this case, to give the Fourth Circuit a full opportunity to consider the serious issue raised by the Commission's construction of Section 533(b)(4), makes good sense.

Bell Atlantic seeks to discount the seriousness of the issue by putting itself in the odd posture of objecting to the Commission's narrowing construction of Section 533(b), a construction that would allow Bell Atlantic to do what its challenge says Section 533(b) forbids: *i.e.*, provide in-region wire-based video programming to subscribers. It turns established principles on their head to seek to broaden rather than narrow statutory restrictions on speech so as to invite rather than avoid a constitutional invalidation of an Act of Congress. Bell Atlantic's several objections to the Commission's construction all have ready answers, made compelling against the backdrop of the demand to save rather than condemn federal statutes. *See, e.g.*, Pet. 18-21; Pet. App. 117a-121a. In any event, it would be appropriate that these arguments initially be presented (as they have not been to date) to the Fourth Circuit.

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[2] No such situation was presented, of course, in *United States v. X-Citement Video, Inc.*, 115 S. Ct. 464 (1994), or the other cases noted in footnote 17 of Bell Atlantic's response.

[3] The principles governing vacatur of a lower-court judgment upon mootness of a case, where the judgment cannot be reentered and no review of the merits will ever be had in the case, are irrelevant to the issue. *See* Br. in Resp. 14-15 (relying on *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 115 S. Ct. 386 (1994)).

CONCLUSION

The petition for a writ of certiorari should be granted and the case either remanded for reconsideration by the Fourth Circuit or set for plenary briefing and argument.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1994

UNITED STATES OF AMERICA, ET AL.;
NATIONAL CABLE TELEVISION ASSOCIATION,
Petitioners,

v.

THE CHESAPEAKE AND POTOMAC TELEPHONE
COMPANY OF VIRGINIA, ET AL., *Respondents*.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

BRIEF OF THE UNITED STATES TELEPHONE ASSOCIATION, NATIONAL TELEPHONE COOPERATIVE ASSOCIATION, ORGANIZATION FOR THE PROTECTION AND ADVANCEMENT OF SMALL TELEPHONE COMPANIES, AMERITECH CORPORATION, BELLSOUTH CORPORATION, FRONTIER CORPORATION, NYNEX CORPORATION, PACIFIC TELESIS GROUP, SBC COMMUNICATIONS INC., THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY, AND U S WEST, INC., AS AMICI CURIAE IN SUPPORT OF RESPONDENTS

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INTEREST OF THE AMICI CURIAE

Amici curiae are companies (and industry associations whose members are companies) that provide telecommunications services to the general public, including local telephone service regulated as common carriage under state laws and the federal Communications Act of 1934.[1] *Amici* file this brief in opposition to petitioners' contention that the Court should summarily vacate the judgment of the court of appeals and remand for further proceedings. *Amici* strongly support respondents' position that the Court should grant certiorari and decide the important constitutional question presented; alternatively, the Court should simply deny certiorari.[2]

Amici, like respondents, are involved in litigation concerning the constitutionality of 47 U.S.C. § 533(b), which prohibits telephone companies from providing "video programming" directly to subscribers within their service areas. In nine other cases (involving these *amici* and *amicus* GTE Service Corporation), as in this case, federal courts have struck down Sec-

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[1] *Amici* United States Telephone Association, National Telephone Cooperative Association, and Organization for the Protection and Advancement of Small Telephone Companies are industry associations whose members — approximately 1400 companies — include virtually all of the traditional local telephone companies in the United States. *Amici* Ameritech Corporation, BellSouth Corporation, Frontier Corporation, NYNEX Corporation, Pacific Telesis Group, SBC Communications Inc., Southern New England Telephone Company, and U S West, Inc. are some of the largest companies whose affiliates or subsidiaries are engaged in the business of providing communications services, including local telephone service. Together with respondents and *amicus* GTE Corporation, *amici* represent virtually every company subject to the free speech restriction in 47 U.S.C. § 533(b).

[2] The parties' letters of consent to the filing of this brief have been filed with the Clerk pursuant to Rule 37.3 of the Rules of this Court.

tion 533(b) as a facial violation of the First Amendment.[3] *Amici* therefore have a substantial interest in this Court's determination of the constitutionality of Section 533(b).

ARGUMENT

Amici file this brief to oppose the government's extraordinary suggestion that this Court vacate the court of appeals' decision holding Section 533(b) unconstitutional on its face, merely because the Federal Communications Commission has suggested that in the future (in circumstances that it has not yet determined), it will waive application of a statute that it has been enjoined from enforcing. There is no basis for this Court to remand the case to the Fourth Circuit as petitioners have requested. The Commission should not be allowed to nullify an adverse judicial ruling merely by announcing in vague terms that it might no longer apply the statute as written. The Commission's recent decision is devoid of meaning in practical terms — in particular, it fails to address the reasons set forth by the Fourth Circuit and other courts for holding the statute unconstitutional — and should be rejected by this Court as a transparent litigation tactic.

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[3] *U S West, Inc.* v. *United States*, 48 F.3d 1092 (9th Cir. 1994); *Pacific Telesis Group* v. *United States*, 48 F.3d 1106 (9th Cir. 1994); *Southern New England Tel. Co.* v. *United States*, No. 3:94-CV-80 (DJS) (D. Conn. Apr. 27, 1995); *Southwestern Bell Co.* v. *United States*, No. 3:94-CV-0193-D (N.D. Tex. Mar. 27, 1995); *GTE South, Inc.* v. *United States*, No. CA-94-1588-A (E.D. Va. Feb 10, 1995), appeal pending 4th Cir. No. 95-1738; *United States Tel. Ass'n* v. *United States*, No. 1:94CV01961 (D.D.C. Feb. 14, 1995), appeal pending D.C. Cir. No. 95-5117; *NYNEX Corp.* v. *United States*, No. 93-1523-P-C (D. Me. Dec. 8, 1994), appeal pending 1st Cir. No. 95-1183; *BellSouth Corp.* v. *United States*, 868 F. Supp. 1335 (N.D. Ala. 1994), appeal pending 11th Cir. No. 94-7036; *Ameritech Corp.* v. *United States*, 867 F. Supp. 721 (N.D. Ill. 1994), appeal pending 7th Cir. No. 95-1223.

After the district court's decision in this case, many of these *amici* sought to intervene in the action, to avoid the necessity of repetitive litigation, acknowledging that they would thereby be bound by the final decision on appeal. See CA App. 16 (docket entries). The government insisted, however, that it was entitled to defend the statute against each of the companies separately. See Gov't Defendants' Mem. in Opp. to Motions to Intervene 10 n.21, 15. In deference to that position, the district court reluctantly denied the motion to intervene. See CA App. 94-95 (order); see also Tr. 63 (Sept. 30, 1993) (denying motion "with reluctance"). Accordingly, the industry has been forced to proceed piecemeal with nine separate lawsuits and attendant appeals, at great expense to itself, the government, the judicial system, and the public. The government has lost in *every* court — indeed, before *every* judge. We consider it outrageous that the government now is arguing that the matter be subjected to additional rounds of litigation, on the basis of "changed circumstances" wholly of its own making.

In this and nine other cases in federal courts around the country, telephone companies have won recognition of their constitutional right to engage in video speech. In every case, before every court, Section 533(b) has been held unconstitutional *on its face* — that is, in *every application*. Now — after years of litigation, when this Court finally has the opportunity to resolve the constitutionality of Section 533(b) — the Commission claims to have discovered a broad power to waive the video programming ban whenever it believes that competition and diversity would be advanced thereby.[4] The

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[4] The Commission makes no secret of the fact that the *Third Report and Order* is motivated by the desire to avoid and set aside adverse court decisions. See *Third Report and Order*, Gov't Supp. Br. App. 7a ("By implementing a 'more speech-friendly' plan * * * we make it unnecessary for those courts to decide whether a complete prohibition on video programming by telephone companies in

FCC has announced its future intention to grant waivers "routinely" to permit telephone companies to provide video programming where they undertake to provide common carrier video transport and they promise to abide by certain unspecified requirements. Gov't Supp. Br. App. 19a.

Neither the vague promises of future intent announced in the *Third Report and Order* nor any elaboration of those promises could justify the extraordinary relief requested by the government. In itself, the *Third Report and Order* does nothing: no telephone company has been given permission to engage in video speech (as is their constitutional *right*, according to the decision below and those in nine other cases). Amazingly, the FCC does not tell us the terms on which such permission might be granted in the future; we have yet to see whether the terms will be economically or technologically feasible.[5] The *Third Report and Order*, like other orders in this docket (see note 7, *infra*), will likely be altered in the process of judicial review and administrative reconsideration. There is no way to know how long it will take to sort all of this out, except that it is likely to take years. Once it is sorted out, there is no way to know how long it will take for the

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their exchange areas is constitutional").

[5] The new policy addresses only the future prospect of telephone companies providing video programming on a "video dialtone" platform. *E.g.*, Gov't Supp. Br. App. 4a-5a. The Court should be aware that "video dialtone" is still at a conceptual and experimental stage; no actual, technologically and commercially viable, video dialtone system has ever been put into place. The particular regulatory requirements to be attached to such a system could well doom it as a realistic means for delivering video programming. In the meantime, if the government's suggestion is accepted, telephone companies will continue to be barred from all the other ways in which they might exercise their First Amendment rights to engage in video speech.

FCC actually to grant waivers.[6] And, of course, there is no way to know whether the Commission will again change its mind, once the immediate threat of this constitutional litigation has been averted. In short, this is the "sort of administrative law shell game" referred to in *MCI Telecommunications* v. *AT&T*, 114 S. Ct. 2223, 2227 (1994) (quoting 978 F.2d 727, 731-32 (D.C. Cir. 1992)).[7]

Even if the FCC had provided a clear announcement that it would waive application of the statute in particular circumstances, vacatur would not be appropriate. This Court has consistently rejected attempts by defendants to avoid appellate review merely by voluntary cessation of unconstitutional conduct. See, *e.g.*, *City of Mesquite* v. *Alladin's Castle, Inc.*, 455 U.S. 283, 288-289 (1982); *Chicago Teacher's Union* v.

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[6] The undisputed record in this case demonstrates that issuance of "good cause" waivers is a very rare event, is likely to be appealed, and frequently takes years when a waiver is granted at all. CA App. 8725 (Joint Stipulations of Fact); *NCTA* v. *FCC*, 914 F.2d 285 (D.C. Cir. 1990).

[7] The history of the FCC's decision-making in this area includes other efforts to avoid judicial review. In 1992, when the Commission first definitively concluded that it should recommend repeal of the statutory ban on telephone company provision of video programming, that decision was challenged in the D.C. Circuit by NCTA and others. The FCC convinced the D.C. Circuit to stay its consideration of the appeal while the FCC resolved administrative petitions for reconsideration. *Mankato Citizens Tel. Co.* v. *FCC*, No. 92-1404 (D.C. Cir. Sept. 9, 1992). The reconsideration phase took over two years, culminating in a new order on November 7, 1994 (See 59 Fed. Reg. 63971), which itself was appealed to the D.C. Circuit. In the meantime, however, the FCC granted a number of applications for video dialtone facilities, and those orders have also been appealed. The FCC has asked the D.C. Circuit to stay consideration of all those appeals while the Commission resolves petitions for reconsideration of its November 7, 1994 order.

Hudson, 475 U.S. 292, 305 n.14 (1986); *United States* v. *W.T. Grant Co.*, 345 U.S. 629, 632-633 (1953). Here, of course, the relief requested by the government — vacatur of the Fourth Circuit's decision without any substantive review by this Court — is even more unprecedented. As noted above, the *Third Report and Order* in fact changes nothing in this litigation: it merely announces a prospective policy, which might not be consistent with the statute, which might not even apply to the respondents, and which the FCC might well reverse once it is free of the injunctions prohibiting the statute's enforcement.

There is no point to the government's suggestion, other than delay and expense. If the government truly believes that its new-found capacity to grant discretionary waivers affects the constitutional issue in this case, then it can argue that position in its brief on the merits.[8] Moreover, if the government believes that a different regulatory regime than the one now in existence would pass constitutional muster, then it is free to enact that regime and let its legality be tested in due course. But none of this is a legitimate justification for frustrating prompt resolution of claims of a constitutional right to speak.

Even if the statute authorized the FCC's newly discovered position concerning its waiver authority,[9] and even if the FCC

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[8] The government cites *United States* v. *X-Citement Video, Inc.*, 115 S. Ct. 464, 467 (1994), for the proposition that a newly discovered interpretation of a statute should be considered on Supreme Court review of the constitutionality of the statute. Gov't Supp. Br. 3-4. But *X-Citement Video* provides no support for the suggestion that the appellate court decision be vacated and the case remanded for reconsideration on the basis of that changed interpretation. To the contrary, the Court reviewed and decided *X-Citement Video* on the merits. The Court should do so here as well.

[9] Waivers may be granted only in situations in which "the issu-

had announced an actual policy (rather than merely the vague promise of future action based on presently unknown factors and conditions), the agency's discretionary policy to grant or deny speech rights could not resolve the constitutional problems presented in this case. *City of Cincinnati* v. *Discovery Network, Inc.*, 113 S. Ct. 1505, 1513-1514 n.19 (1993) (striking down a regulatory licensing scheme that vested "unbridled discretion in a government official"); *Secretary of State* v. *J.H. Munson Co.*, 467 U.S. 947, 964 n.12 (1984) (noting constitutional concerns raised by a statute that "plac[es] discretion in the hands of an official to grant or deny a license"); see also *id.* at 968 ("[t]he possibility of a waiver may decrease the number of impermissible applications of the statute, but it does nothing to remedy the statute's fundamental defect").

At best, the *Third Report and Order* may allow *some* telephone companies, on terms *to be specified in the future*, in the *discretion* of the Commission, to engage in *some forms* of video speech. By contrast, under the decision below, these companies have a *constitutional right* to engage in video speech *now*, because the government failed to demonstrate a constitutionally valid justification for silencing them. We are at a loss to understand how the government's grudging willingness, under pressure of adverse court rulings, to give limited discretionary permission for some speech, can possibly

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ance of such waiver is justified by the petitioner, taking into account the policy of this subsection." 47 U.S.C. § 533(b)(4). The Commission seeks to base the waivers contemplated by the *Third Report and Order*, however, not on the policy of the subsection, but rather on its *repudiation* of that policy. The government's litigating position in this and related cases has been that the Congressional policy in enacting Section 533(b) was to enhance competition in the cable industry by *barring* telephone companies from providing video programming in their telephone service areas. See, *e.g.*, Pet. App. 17a-18a; see also *NCTA*, 914 F.2d at 289.

substitute for the constitutional right recognized by the court below (and by every other court to have considered the issue).

If plaintiffs had successfully challenged a state law banning political demonstrations in a public park, this Court would not vacate the judgment and remand merely because the sheriff announced — in response to multiple court injunctions — that he would waive the ban on demonstrations, in future unspecified circumstances, for "good cause." Although the technology in this case may be more complex, the principle is the same.

In sum, the court below has declared a federal statute unconstitutional. It is essential that both the government and the industry regulated by the statute know, as expeditiously as possible, whether that decision is correct. Telephone companies across the nation are poised to invest substantial resources in constructing the infrastructure needed to bring competition to this previously monopolized medium of communication. The government should not be allowed — after having lost in every court — to prolong the uncertainty preventing this important development. Accordingly, the Court should promptly grant review and set the case for plenary briefing and oral argument.

CONCLUSION

The petition for a writ of certiorari should be granted, and the government's suggestion that the judgment of the court of appeals be vacated and the case remanded for further proceed-

ings should be rejected. In the alternative, the Court should deny certiorari.

Respectfully submitted,

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Respondents.

On Petitions for Writ Of Certiorari to the
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BRIEF OF AMICUS CURIAE GTE CORPORATION IN SUPPORT OF RESPONDENTS

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Dated: May 31, 1995

RULE 29.1 STATEMENT

Amicus curiae GTE Corporation is a publicly-held corporation in the business of providing telecommunications services and products to the general public. GTE Corporation is the parent company of GTE Service Corporation and the GTE telephone operating companies. The following subsidiaries of GTE Corporation have securities in public hands:

BC Telecom, Inc.
Caribbean Reservation Center, C. por A.
Communicaciones Telefonicas, C. por A.
Florence Cellular Telephone Company, Inc.
GTE California Incorporated
GTE Directories Corporation Lanka (PVT.) Ltd.
GTE Florida Incorporated
GTE Hawaiian Telephone Company Incorporated
GTE North Incorporated
GTE Northwest Incorporated
GTE South Incorporated
GTE Southwest Incorporated
Jacksonville Cellular Telephone Corp.
Jacksonville Cellular Communications, Inc.
La Compagnie de Telephone Anglo-Canadienne/
Anglo-Canadian Telephone Company
MTX Italia
Parque Industrial ITABO, S.A.
Quebec-Telephone
Radiowealth, Inc.
The Micronesian Telecommunications Corporation
Wilmington Cellular Telephone Corp.
Wilmington Cellular Communications, Inc.
Zona France Las Americas

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IN THE

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BRIEF OF AMICUS CURIAE GTE CORPORATION IN SUPPORT OF RESPONDENTS

INTEREST OF AMICUS CURIAE

Amicus curiae GTE Corporation and its affiliated companies are in the business of providing telecommunications services and products, including local telephone services, to the general public. *Amicus*, like respondent Bell Atlantic, has challenged the constitutionality of 47 U.S.C. § 533(b), which prohibits telephone companies from providing "video programming" to subscribers in their service area. In *GTE South v. United States*, Civ. Action No. 94-1588-A (E.D. Va. Jan. 15, 1995), the District Court declared that § 533(b), on its face, violates GTE's right of free speech guaranteed by the

First Amendment of the United States Constitution. The Government has filed a notice of appeal in *GTE South*, but the parties have agreed to stay that appeal pending resolution of this case by this Court. *Amicus* GTE Corporation therefore has a substantial interest in this Court's determination of the constitutionality of § 533(b).[1]

ARGUMENT

Amicus GTE Corporation respectfully submits that this Court should either: (i) deny the petitions for writ of *certiorari*; or (ii) grant them and consider this case on the merits. In no event, however, should the Court indulge the Government's request to grant the petition, vacate the judgment below, and remand for further consideration ("GVR") without considering the case on the merits.

The speech-regulating regime embodied in the FCC's *Third Report and Order*, FCC 95-203 (May 16, 1995) (reprinted in Appendix to Govt. Supp. Br. at 1a-21a), is either a significant new legal development or it is not. GTE believes it is not. But either way, the *Third Report and Order* most assuredly does not justify a GVR.

I. BECAUSE THE "GOOD CAUSE" WAIVER ARGUMENT IN THE *THIRD REPORT AND ORDER* IS NOT NEW, THE PROPER WAY FOR THE GOVERNMENT TO PURSUE THAT ARGUMENT IS ON THE MERITS IF THIS COURT GRANTS *CERTIORARI*.

We believe that, for purposes of the important constitutional questions presented by this case, there is nothing new in the *Third Report and Order*. Indeed, the *Third Report and Order* is really nothing more than a legal brief, signed by

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[1] GTE has obtained the written consent of Petitioners, the United States and the National Cable Television Association ("NCTA"), as well as of Respondent Bell Atlantic Corporation, to file this *amicus* brief. The letters of consent are on file with the Clerk of this Court.

the FCC, that attempts to "beef up" the very legal argument the Government lost below.

The "good cause" waiver provision has always been in the statute, which was enacted in 1984. Moreover, as Bell Atlantic explains in its Response, the Complaint in this case specifically alleged that the "good cause" waiver provision was unconstitutional and the Government argued below that the "good cause" waiver provision "obviate[d] the [need]" for invalidating § 533(b). *See* Resp. Br. at 19 n.27. Furthermore, by invalidating the statute *on its face*, the courts below necessarily rejected the Government's "good cause" waiver argument and determined that *no* possible application of the statute's waiver proviso could save its constitutionality. *See, e.g., United States v. Salerno*, 481 U.S. 739, 745 (1987) (facial "challenger must establish that *no set of circumstances exists* under which the [statute] would be valid.") (emphasis added).

Nor does the *Third Report and Order* adopt any specific new standards that meaningfully alter the capacity of the "good cause" waiver provision to "save" § 533(b) from unconstitutionality. To the contrary, the *Third Report and Order* does not even attempt to set forth what specific standards and conditions will govern the FCC's decision whether to grant a "good cause" waiver.

Because, in our view, there is nothing new about the Government's "good cause" waiver argument, the proper way to consider it is *on the merits* if the Court grants *certiorari*. *See, e.g., United States v. X-Citement Video, Inc.*, 115 S. Ct. 464 (1994) (considering *on the merits* a saving construction urged by the Government for the first time in this Court). But it is ridiculous to suggest that this Court should GVR on the basis of a legal argument that was raised and necessarily rejected below, merely because it now has been repackaged by the Government and duly ratified by the relevant agency.

II. IF THE *THIRD REPORT AND ORDER* REALLY ALTERS THE LEGAL LANDSCAPE, THE PROPER DISPOSITION OF THIS CASE IS TO DENY THE PETITIONS FOR *CERTIORARI*.

Even if, however, the Court were to take at face value the Government's suggestion that the "good cause" waiver interpretation offered by the FCC is new and alters "the legal landscape," Govt. Supp. Br. at 6, that still would be no reason to GVR. This Court has previously held that a party may not obtain vacatur of a judgment below by voluntarily ceasing or altering its conduct. *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 115 S. Ct. 386 (1994); *see also Northeastern Florida Contractors v. Jacksonville*, 113 S. Ct. 2297 (1993) (losing party's voluntary cessation of challenged conduct does not render case moot). There is good reason for this rule. Were the law otherwise, a losing party could effectively postpone the day of final judicial reckoning by simply altering its conduct in the wake of an adverse lower-court decision, and then asking this Court to vacate that judgment to try its luck again below. Our system of justice neither contemplates nor tolerates such judicial ping-pong.[2]

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[2] Neither the Government nor the NCTA cites any case in which this Court has vacated the judgment of a Court of Appeals holding a statute unconstitutional because a party has subsequently come up with a "saving" construction of the statute. Much less have petitioners cited a case analogous to this one—where this Court has GVR'd when an administrative agency, *which was a losing party to the case*, has issued a saving construction *that was previously raised* in the lower courts.

The only case cited by the Government (*see* Govt. Pet. at 16-17) in support of its request for a GVR is *Bureau of Economic Analysis v. Long*, 454 U.S. 934 (1981). That case, however, involved an intervening Act of Congress that changed the governing substantive law in the case. It therefore differs from this case in two significant ways: (i) the asserted basis for GVR was not the action of one of the parties to the litigation, and (ii) the asserted basis for GVR was a *bona fide* legal development, not simply a reformulation of an argument advanced unsuccessfully below.

(continued...)

Thus, if the *Third Report and Order* does establish a new legal regime, the proper disposition of this case is to deny the petitions. If a litigant really changes the legal regime by altering its conduct, there is no basis to overturn the Court of Appeals decision, which decided the case correctly as presented. Thus, if the "good cause" waiver interpretation is indeed something new, the Government should defend the new legal regime embodied in the *Third Report and Order* in another case.

III. WHETHER THE "GOOD CAUSE" WAIVER INTERPRETATION IS OLD OR NEW, IT SURELY DOES NOT SAVE § 533(b) FROM UNCONSTITUTIONALITY.

In any event, whether the "good cause" waiver argument contained in the *Third Report and Order* is old or new, it surely does not save § 533(b) from unconstitutionality. This too militates strongly against indulging the Government's request for a GVR, as it would be a pointless delay of the final vindication of the telephone companies' First Amendment rights.

As a predicate matter, it does not appear that the FCC's interpretation of "good cause" waiver provision in § 533(b)(4) is a permissible reading of the statute. The authority granted by Congress to issue a "good cause" waiver based on the particularized circumstances of the applicant is *not* the authority "routinely" to issue waivers for an entire industry. *See Third Report and Order*, Govt. Supp. Br. at 19a ("[W]e

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[1] (...continued)

We have discovered *no* case in which this Court has GVR'd a lower-court judgment on the ground that the *losing* party below has altered its conduct in a manner asserted to be legally significant. *Cf. City of Chicago v. Environmental Defense Fund*, 113 S. Ct. 486 (1992) (GVR'ing after federal agency—which was *not* a party—clarified construction of statute while case pending before Court); *Oberly v. Baltimore & Ohio R.R.*, 479 U.S. 980 (1986) (GVR'ing after Solicitor General disavowed position taken by federal agency as *amicus* in court of appeals).

will *routinely* grant a waiver . . . where the telephone company agrees to abide by the regulations we will establish governing its provision of video programming.") (emphasis added). A "routinely" issued "good cause" waiver is an oxymoron, *cf. Kleem v. INS*, 479 U.S. 1308 (1986) (Scalia, J., in chambers); *Madden v. Texas*, 498 U.S. 1301, 1304 (1991) (Scalia, J., in chambers), and would eviscerate the flat prohibition contained in § 533(b).[3]

In addition, even if § 533(b)(4) authorized the grant of routine waivers, the interpretation contained in the *Third Report and Order* would not save § 533(b) from unconstitutionality. The regime described by the *Third Report and Order* is nothing more than a flat ban on speech accompanied by a grant of standardless discretion to an administrative agency to license exceptions to the flat ban on speech. This Court has repeatedly held that the government "cannot vest restraining control over the right to speak [in] an administrative official where there are no appropriate standards

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[3] Indeed, the interpretation of the "good cause" waiver provision contained in the *Third Report and Order* is flatly inconsistent with the only authoritative judicial interpretation of § 533(b)(4). In *NCTA v. FCC*, 914 F.2d 285 (D.C. Cir. 1990), the Court of Appeals, at the NCTA's behest, vacated an FCC order granting a good cause waiver to a telephone company. The Court held that "[t]he policy of [§ 533(b)], which the Commission must take into consideration, is to prohibit a telephone company's crossownership of a cable facility absent a finding that a community would not otherwise be served by cable or because the waiver is justified by good cause," and that the waiver was unavailable absent a showing that telephone company participation was "necessary" to the operation of the cable system. *Id.* at 289.

The *Third Report and Order* also flies in the face of the FCC's prior observation that the legislative history of § 533(b) makes plain that "it is the policy of [§ 533(b)] that telephone companies should be prohibited from providing video programming directly to their subscribers in their telephone service area. ***The waiver authority should be narrowly construed and exercised in a manner that does not undermine the basis policy of this subsection.***" *Telephone Company-Cable Television Cross Ownership Rules*, 3 FCC Rcd 5849, 5850 (1988) (quoting 130 Cong. Rec. H 10,444 (daily ed. Oct. 1, 1984) (emphasis added).

to guide his action." *Kunz v. New York*, 340 U.S. 290, 295 (1951). *See also City of Cincinnati v. Discovery Network, Inc.*, 113 S. Ct. 1505, 1509 n.9 (1993).

For First Amendment purposes, the waiver regime described in the *Third Report and Order* is indistinguishable from a municipality's flat ban on picketing, accompanied by a promise by the mayor that he will grant exceptions to ban according to "speech friendly" standards that he will develop later when he gets around to it. *See Third Report and Order*, Govt. Supp. Br. at 3a-4a) (promising to be "speech-friendly" in granting waivers). It is inconceivable that such a regime passes First Amendment muster. Indeed, the FCC's standardless scheme only strengthens the case that § 533(b) is subject to strict scrutiny.

IV. THE GOVERNMENT'S REQUEST TO GVR SHOULD BE DENIED TO PREVENT MANIPULATION OF THE JUDICIAL PROCESS.

Finally, the Government's request for a GVR should be denied to prevent manipulation of the judicial process. The "good cause" waiver provision in § 533(b)(4) has been part of the statute since it was passed in 1984 (and, indeed, was part of the FCC-imposed prohibition on telephone company video speech even earlier). The FCC could have issued this interpretation any time before this case was filed or while it was being considered in the District Court and Court of Appeals. It even could have done this in the year since the Court of Appeals decided this case. Or, for that matter, the interpretation contained in the *Third Report and Order* could be advanced in this Court if *certiorari* were granted, since the defense was at issue below.

The circumstances surrounding the release of the *Third Report and Order* make it apparent that the document was carefully timed to persuade this Court to GVR without considering this case on the merits. The FCC's "new" interpretation came just one day before the Solicitor General filed his petition for *certiorari*, which in turn was followed

immediately by the Solicitor General's supplemental brief requesting a GVR. We respectfully suggest that this conduct is wrong, and should not be rewarded. Indeed, if the Court were to grant the Government's novel request, we think it would set an unfortunate precedent encouraging litigants (particularly the Government) to time purported changes in the "legal landscape" to manipulate this Court's GVR power to vacate adverse decisions and evade review on the merits.

CONCLUSION

For all the reasons stated herein this Court should either (i) deny the petitions for *certiorari*, or (ii) grant them and set the case for plenary briefing and argument in the usual course. In no event, however, should this Court vacate the decision of the Court of Appeals and remand the case for further consideration.

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Nos. 94-1893 and 94-1900

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

UNITED STATES OF AMERICA, *et al.*

and

NATIONAL CABLE TELEVISION ASSOCIATION, *et al.*,
Petitioners,

v.

BELL ATLANTIC CORPORATION, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF *AMICUS CURIAE* OF THE CALIFORNIA CABLE TELEVISION ASSOCIATION IN SUPPORT OF PETITIONERS

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BRIEF *AMICUS CURIAE* OF THE CALIFORNIA CABLE TELEVISION ASSOCIATION IN SUPPORT OF PETITIONERS

INTEREST OF *AMICUS CURIAE*

The California Cable Television Association ("CCTA") submits this brief as *amicus curiae* in support of petitioners.[1]

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[1] Consistent with S. Ct. R. 37.3, all parties have given CCTA their consent to the filing of this brief. Two members of CCTA, Time Warner Cable and Home Box Office, are not represented by CCTA for purposes of this action.

CCTA is a trade association representing cable television system operators that provide cable television service to nearly six million California residents, as well as cable television programmers and equipment suppliers. CCTA brings information to the Court concerning the effect elimination of the in-region bar on telephone company provision of video programming has had, and will continue to have, on cable television operators and consumers in California. CCTA has unique knowledge of the incentive and ability of local exchange carriers ("LECs") in California—specifically, Pacific Bell ("Pacific") and GTE Corporation—to engage in anticompetitive behavior in a manner that directly affects the ability of cable operators to compete effectively in the marketplace. Notably, this anticompetitive conduct is at the heart of the congressional justification for Section 533(b) of the Communications Act.

Since 1958, CCTA has participated in proceedings before a wide range of administrative, legislative, and judicial bodies on behalf of the cable television industry in California and its individual members. CCTA has a wide range of experience advocating the rights of cable television operators before this Court [2] and before the Court of Appeals for the Ninth Circuit.[3] Most recent and relevant to the questions posed by the petitioners for certiorari, CCTA filed a brief as intervenor-applicant in the Ninth Circuit Court of Appeals when the district court

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[2] See *amicus* briefs filed by CCTA in *Turner Broadcasting System, Inc. v. FCC*, 114 S. Ct. 2445 (1994) and *Leathers v. Medlock*, 499 U.S. 439, 111 S. Ct. 1438 (1991).

[3] CCTA has filed *amicus* briefs in *Preferred Communications, Inc. v. City of Los Angeles, California, and Department of Water and Power*, 754 F.2d 1396 (9th Cir. 1985), *aff'd*, 476 U.S. 488 (1986); and *Preferred Communications, Inc. v. City of Los Angeles, California, and Department of Water and Power*, 13 F.2d 1327 (9th Cir. 1994), *cert. denied*, 114 S. Ct. 2738 (1994).

invalidated the telephone company-cable operator cross-ownership ban at issue in this case.[4]

This *amicus* brief will illustrate that the issues the petitioners ask this Court to resolve will have a substantial impact on competition in the provision of multichannel video programming, the video services market, and the market for local telephone competition as well.[5]

REASONS FOR GRANTING THE PETITION

The central issue in this case is whether a non-content based regulation, which the court of appeals found promotes the significant governmental interest in media outlet diversity and deterrence of anticompetitive behavior,[6] violates the First Amendment because there might be less burdensome alternatives, without regard to how effective such alternatives might be at accomplishing the governmental interest.

To find, as the court of appeals did, that the telephone company-cable television cross-ownership ban was not narrowly tailored enough to pass constitutional muster[7]

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[4] See Brief of CCTA in *U S West, Inc. v. United States*, 48 F.3d 1092 (9th Cir. 1994). The court of appeals ultimately denied CCTA intervenor status in that case and, thus, CCTA participated as *amicus curiae*. CCTA, however, participated in joint oral argument of the *U S West* case in its capacity as an intervenor in *Pacific Telesis Group v. United States*, 48 F.3d 1106 (9th Cir. 1994), *rehearing pending*, which also involved a constitutional challenge to Section 533(b). In addition, CCTA was a party in *GTE California, Inc. v. FCC*, 39 F.3d 940 (1994).

[5] In the alternative to this Court's review, CCTA supports the petitioners' request that the decision of the court of appeals be vacated and remanded for further consideration in light of the FCC's action in *Telephone Company-Cable Television Cross-Ownership Rule, Sections 63.54-63.58, Third Report and Order*, FCC 95-203 (released May 16, 1995).

[6] Pet. App. 34a.

[7] Pet. App. 42a.

flies in the face of the "real life" experience CCTA's members have had with anticompetitive conduct by California's LECs. The simplistic assumption that other less burdensome options exist, or that the Federal Communications Commission ("FCC") has the requisite means to enforce conduct-specific regulation, fails to take into account the overwhelming incentive and ability of telephone companies to use their monoply power to cross-subsidize and discriminate against competitors in the video services market.

The cross-ownership ban was first adopted by the FCC in 1970 to address the problem of discrimination against cable companies unaffiliated with LECs and to avoid the extension of the telephone company monopoly into the cable services market.[8] The FCC concluded that "the preservation of . . . competition will best be assured by the exclusion of telephone companies in their service areas from engaging in the sale of [cable] service to the viewing public." [9]

In 1981, the FCC revisited this subject with the issuance of a comprehensive staff report on the agency's cable cross-ownership policies.[10] While the report noted that the cable industry no longer was in its infancy, it concluded that continued prohibition of telephone company-cable television cross-ownership "remains essential." [11] It stated that the restriction should not be lifted until the potential of cable television operators to become genuine competitors of telephone companies with respect

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[8] See 47 C.F.R. 64.601 (1971); *Applications of Telephone Companies for Section 214 Certificates for Channel Facilities Furnished to Affiliated Community Antenna Television Systems*, 21 F.C.C.2d 307 (1970), aff'd *sub nom. General Tel. Co. of Southwest v. United States*, 449 F.2d 846 (5th Cir. 1971).

[9] 21 F.C.C.2d at 325.

[10] FCC Office of Plans and Policy, *FCC Policy on Cable Ownership, A Staff Report* (Nov. 1981).

[11] *Id.* at 177. *See also id.* at 143 (restriction "must be retained for the time being.").

to local telephone service became more realistic. The report observed that independent cable operators offered the potential "to constrain telephone company market power" and "long run prospects for eliminating the 'local bottleneck' altogether." [12] Thus, the FCC explained, the decision of whether to lift the cross-ownership ban "depends critically on the nature of competition in the provision of local loop services." [13]

In this vein, Congress essentially codified the FCC's cross-ownership rules in Section 533(b) of the Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2779, 47 U.S.C. 533(b). It indicated that the ban was intended "to prevent the development of local media monopolies, and to encourage a diversity of ownership of communications outlets." [14]

The key factual predicate that prompted the ownership ban still exists today. Specifically, LECs continue to enjoy overwhelming local access market dominance. Nationwide, industry analysts reported last year that aggregate revenues for access services of all competitive local telephone access providers combined are less than one percent of total monopoly LEC access revenues and an even smaller percentage of total revenues.[15] Indeed, in California, local telephone companies retain a *de jure* monopoly [16] and are resisting efforts to open up the local exchange market to meaningful competition.[17]

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[12] *Id.* at 160.

[13] *Id.* at 177.

[14] H.R. Rep. No. 934, 98th Cong., 2d Sess. 56 (1984).

[15] Economics and Technology, Inc./Hatfield Associates, Inc., "The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers," at ii (February, 1994).

[16] See *In the Matter of Alternative Regulatory Frameworks for Local Exchange Carriers*, CAL. PUB. UTIL. Decision No. 89-10-031.

[17] See Comments of Pacific in *In the Matter of Alternative Regulatory Frameworks for Local Exchange Carriers*, CAL. PUB. UTIL. Investigation No. 87-11-033 (filed January 31, 1995).

The Ninth Circuit recently reaffirmed that "the BOCs have the incentive to discriminate [in the provision of enhanced services] and the ability to exploit their monopoly control over the local networks to frustrate regulators' attempts to prevent anticompetitive behavior." [18] This incentive to use network facilities to the detriment of competing video programmers and providers is especially strong in the context of LEC-provided video service because the LECs already have a wired connection into nearly every home. Thus, LECs are looking to provide video services to consumers who are their captives for telephony.

CCTA has had first-hand experience with telephone company attempts to exploit their extraordinary market power to gain a competitive advantage in the video services market. For example, in 1986, Pacific constructed a "leaseback" video transport cable system for an independent cable operator in Palo Alto, California, and estimated that the system's annual revenue for the first 15 years would recover its costs and yield a rate of return on Pacific's investment of between 10 and 12.72 percent.[19] Although Pacific's construction costs, in fact, had vastly exceeded its estimate, the company never increased its tariffed rates to the customer.[20] As a result, potential competitors were injured because Pacific required telephone ratepayers to bear the burden of its loss.

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[18] *California v. FCC*, 39 F.3d 919, 929 (9th Cir. 1994), *cert. denied*, 115 S. Ct. 1427 (1995).

[19] Application of Pacific Bell for Authority Pursuant to Section 214 of the Communications Act of 1934, and Section 63.01 of the Commission's Rules and Regulations to Construct and Maintain Broadband Cable Distribution Facilities in and around the City of Palo Alto, CA, File No. W-P-C 5753 (filed April, 1986 and amended September, 1986).

[20] See Reply of the California Cable Television Association to Pacific Bell's Opposition to Petitions to Deny, FCC File Nos. W-P-C 6913, 6914, 6915, and 6916, at 39-42 (filed March 11, 1994).

Significantly, this conduct, which violated Pacific's tariff and the FCC's cross-ownership rules, was not prevented by the accounting "safeguards" imposed by the FCC.

Pacific's pending proposals to provide video dialtone service are even more striking.[21] Pacific claims that its $16 billion investment in a new hybrid fiber/coaxial cable telecommunications network is nothing more than a replacement of its copper telephone network and not intended primarily to give Pacific the ability to provide video programming.[22] Therefore, Pacific claims it needs no regulatory approval for most of its investment and has, in fact, initiated construction of its new network with no intervention by the FCC.[23]

On the basis that the $16 billion investment is primarily for the purpose of telephony, Pacific also proposes that its embedded monopoly telephone ratepayers bear the cost of its new video network. Specifically, Pacific proposes to scrap millions of copper wires, substitute broadband coaxial cable "drops", even for households that only want basic telephone service, build a broadband feeder and distribution system to carry both video and telephony, and then charge off 78 percent of the new network to regulated telephony services, when less than half of these costs should be borne by telephone ratepayers.[24] This massive

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[21] Applications of Pacific Bell for Authority Under Section 214(a) of the Communications Act to Construct Video Dialtone Facilities, File Nos. W-P-C- 6913, 6914, 6915, 6916 (filed December 20, 1993).

[22] *Id.*

[23] See Letter from Jeffrey Sinsheimer, Director of Regulatory Affairs, CCTA, to Kathleen M.H. Wallman, Chief, Common Carrier Bureau, FCC, at 12, FCC File Nos. W-P-C 6913, 6914, 6915, 6916, dated April 11, 1995, citing Letter from Alan Ciamporcero, Pacific Telesis, to Kathleen M.H. Wallman, FCC, at 8, dated January 13, 1995.

[24] See Letter from Jeffrey Sinsheimer, Director of Regulatory Affairs, CCTA, to Kathleen M.H. Wallman, Chief, Common Carrier Bureau, FCC, Exhibit 1 at 2 (Declaration of Leland L. Johnson, Ph.D.), FCC File Nos. W-P-C 6913, 6914, 6915, 6916, dated April 11, 1995.

cost-shifting away from video dialtone users will allow Pacific to underprice other video providers at the same time that it unfairly burdens its ratepayers.

Most significantly, Pacific's video dialtone proposals to provide common carriage service are nothing more than a Trojan Horse for the company's provision of video programming. Specifically, Pacific expects that its offering will be governed by common carrier regulations, although it proposes to grant discriminatory access and rates to a "favored" video programmer.[25] And, if the First Amendment questions before this Court are resolved in a manner that will permit the telephone company to provide video programming in its service area, Pacific intends to purchase this "favored" programmer.[26]

It is far from clear that the FCC possesses the means to police anticompetitive conduct of this sort in the absence of LEC ownership of video programming. It is readily apparent, however, that the agency will not be able to deter LECs from extending their telephone monopolies into the video transport market when they have the added incentive of gaining dominance over the lucrative video programming business. In light of this evidence, it is not apparent why the court of appeals believes that limiting "the telephone companies' editorial control over video programming to a fixed percentage of the channel's available" would be an effective "less-burdensome alternative" to Section 533(b).[27]

Finally, there is simply no evidence that this limited economic regulation has any impact whatsoever on the ability of LECs to get their desired messages to local subscribers. Section 533(b) allows telephone companies ample avenues for communication, including dissemina-

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[25] See Letter from Spencer Kaitz, President, CCTA, to Reed Hundt, Chairman, FCC, FCC File Nos. W-P-C 6913, 6914, 6915, 6916, dated September 19, 1994.

[26] *Id.*

[27] Pet. App. 41a.

tion of video programming by any means except LEC-owned in-region cable systems, as well as any expression that does not constitute video programming. In contrast to the minimal effect the cross-ownership ban has on telephone company speech, the regulation promotes competition and ensures that the LEC vision of just one (LEC-owned) wire into each home does not become a reality.

CONCLUSION

For the foregoing reasons, the petitions for a writ of certiorari should be granted.

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v.

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA, ET AL.

NATIONAL CABLE TELEVISION ASSOCIATION, INC., PETITIONER

v.

BELL ATLANTIC CORPORATION, ET AL.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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NOTICE

The following opinions and order have been omitted in printing this appendix because they appear in the following pages in the printed appendix to the petition for a writ of certiorari in No. 94-1893:

Opinion of the Court of Appeals (November 21, 1994).. 1a

Opinion of the District Court (August 24, 1993) 53a

Order of the Court of Appeals Denying Rehearing (January 18, 1995) 109a

Federal Communications Commission, Fourth Further Notice of Proposed Rulemaking (January 20, 1995).. 113a

The following order has been omitted from this appendix because it appears in the printed appendix to the supplemental brief of petitioners in support of the petition for a writ of certiorari in No. 94-1893:

Federal Communications Commission, Third Report and Order (May 16, 1995) 1a

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

No. 92-CV-1751

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA, ET AL., PLAINTIFFS

v.

UNITED STATES OF AMERICA, ET AL., DEFENDANTS

RELEVANT DOCKET ENTRIES

DATE	No.	PROCEEDINGS
12/17/92	1	COMPLAINT Filing Fee $120.00 Receipt #93884 (bonn)
		* * * * *
2/8/93	3	MOTION to Intervene as a deft by Natl Cable TV (bonn) [Entry date 02/09/93]
2/8/93	4	MEMORANDUM by Natl Cable TV in support of [3-1] motion to Intervene as a deft by Natl Cable TV (bonn) [Entry date 02/09/93]
2/8/93	5	ANSWER to Complaint by Natl Cable TV (Attorney, James Saunders), (bonn) [Entry date 02/09/93]
		* * * * *
2/16/93	8	ANSWER to Complaint by William Barr, FCC, United States (Attorney Richard Parker), (bonn) [Entry date 02/18/93]
		* * * * *

DATE	No.	PROCEEDINGS
3/1/93	13	ORDER this matter comes before the court on the motion of the National Cable Television Association, Inc. to intervene as a deft, for the reasons stated from the bench: NCTA's motion to intereven [*sic*] as a right, is denied, NCTA's motion for permissive intervention, is gratned [*sic*] subject to the following conditions (see order for details) the parties are futher [*sic*] directed to submit to the court a mutually agreeable briefing sch. and culminating in oral argument on either 5/13/93, 5/20/93 or 5/27/93 ent - filed (signed by Judge T. S. Ellis III) Copies Mailed: yes (rvoi) [Entry date 03/02/93]
		* * * * *
4/30/93	46	MOTION by Chesapeak [*sic*] & Potomac, Bell Atlantic Video for Summary Judgment (bonn)
4/30/93	47	JOINT stipulation of fact - file by parties. (bonn)
		* * * * *
4/30/93	49	LIST of authenticated documents - filed by parties. (bonn)
4/30/93	50	AFFIDAVITS and Excerpts from principal government documents in support of motion for summary judgment - filed by pltfs. (bonn)
		* * * * *
5/21/93	65	CROSS MOTION by Natl Cable TV for Summary Judgment (bonn) [Entry date 05/24/93]
		* * * * *
5/24/93	67	MOTION by United States, FCC for Summary Judgment (bonn)
		* * * * *

DATE	No.	PROCEEDINGS
6/7/93	77	OBJECTIONS by Bell Atlantic Video, Chesapeak & Potomac to exhibits filed in connection with summary judgment (bonn)
		* * * * *
8/24/93	96	MEMORANDUM OPINION (signed by Judge T. S. Ellis III) Copies Mailed: yes (rvoi) [Edit date 08/24/93]
8/24/93	97	ORDER this matter comes before the court on cross-motions for summary judgment, for the reasons stated in the accompanying memorandum opinion, pltf's motion for summary judgment is gratned, [*sic*] and defts' and intervenor-defts' motion for summary judgment are denied. Defts are hereby enjoined from enforcement of 47 USC 533 entfiled (signed by Judge T. S. Ellis III) Copies Mailed: yes (rvoi)
		* * * * *
9/8/93	99	MOTION for relief from judgment and to alter or amend judgment by United States, FCC, Janet Reno (bonn)
		* * * * *
9/8/93	102	MOTION to intervene by Ameritech Corporation, BellSouth Corporation, GTE Service Corporation, NYNEX Corporation, Pacific Telesis Group, Rochester Telephone Corporation, Southwestern Bell Corporation and US West, Inc. (bonn) [Entry date 09/09/93]
		* * * * *
9/20/93	110	MOTION for joinder of parties as pltfs by Chesapeak & Potomac, Bell Atlantic Video (bonn) [Entry date 09/21/93]
		* * * * *

DATE	No.	PROCEEDINGS
10/7/93	121	ORDER granting [110-1] motion for joinder of parties as pltfs by Chesapeak & Potomac Bell Atlantic Video, granting with respect to specifying that the order dated 9/8/93 applies only to Section 533(b) and not to the entire Section 533 and denying all other aspects of the [99-1] motion for relief from judgment and to alter or amend judgment by United States, FCC, Janet Reno, denying [105-1] motion to intervene by GTE Virginia and GTE Vantage Inc., denying [102-1] motion to intervene by Ameritech Corporation, BellSouth Corporation, GTE Service Corporation, NYNEX Corporation, Pacific Telesis Group, Rochester Telephone Corporation, Southwestern Bell Corporation and US West, Inc. - entered & filed (signed by Judge T. S. Ellis III) Copies Mailed: Yes (bonn)
10/7/93	122	AMENDED FINAL ORDER that the court's memorandum opinion dated 8/24/93, pltfs' motion for summary judgment is granted, and defts' and intervenor-deft's motions for summary judgment are denied. The court declares 47 USC Section 533(b) unconstitutional both on its face and as applied to pltfs. The following parties are joined as pltfs: Bell Atlantic Corporation, The Chesapeake and Potomac Telephone Company. The Chesapeake and Potomac Telephone Company of Maryland, The Chesapeake and Potomac Telephone Company of West Virginia, The Diamond State Telephone Company, New Jersey Bell Telephone Company and the Bell Telephone Company of Pennsylvania. Defts. are hereby enjoined from enforcement of 47 USC Section 533(b) against the above named parties. This order supersedes and

DATE	No.	PROCEEDINGS
		replaces the court's order dated 8/24/93 - entered & filed. (signed by Judge T. S. Ellis III) Copies Mailed: Yes (bonn)
		* * * * *
10/15/93	124	NOTICE OF APPEAL of orders of 10/7/93, and 8/24/93 by Janet Reno, FCC, United States. Copy of notice mailed to all parties. Copy of notice, orders and docket entries mailed to USCA. (bonn) [Entry date 10/18/93]
		* * * * *

[Filed Dec. 17, 1992]

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

Civil Action No. 92-1751-H

THE CHESAPEAKE AND POTOMAC
TELEPHONE COMPANY OF VIRGINIA,
600 East Main Street
Richmond, Virginia 23219

and

BELL ATLANTIC VIDEO SERVICES COMPANY,
1320 N. Court House Road
Arlington, Virginia 22201

PLAINTIFFS

v.

UNITED STATES OF AMERICA,

FEDERAL COMMUNICATIONS COMMISSION,
1919 M Street, N.W.
Washington, D.C. 20554

and

WILLIAM P. BARR, in his official capacity as
Attorney General of the United States of America,
Department of Justice
10th & Constitution Ave., N.W.
Washington, D.C. 20530

DEFENDANTS

For All Defendents, Serve:

Richard Cullen
United States Attorney for the
Eastern District of Virginia
1101 King Street, Suite 502
Alexandria, Virginia 22314

COMPLAINT FOR DECLARATORY JUDGMENT AND INJUNCTIVE RELIEF

1. The Cable Communications Policy Act of 1984, 47 U.S.C. § 533(b) ("Cable Act"), prohibits The Chesapeake & Potomac Telephone Company of Virginia and its affiliate, Bell Atlanic Video Services Company, from providing video programming—including television shows, movies, sports, news, and political reporting and opinions —to subscribers in C&P's telephone service area. This is an action pursuant to 28 U.S.C. §§ 2201 and 2202 to declare this prohibition unconstitutional and to enjoin the defendants from enforcing it. The government defendants, who bear the burden of justifying this prohibition, have stated that the prohibition is not necessary to serve any valid governmental purpose and that it should be repealed. Congress, however, has failed to repeal the prohibition, and the defendants have indicated that they will continue to enforce it.

JURISDICTION AND VENUE

2. This Court has subject matter jurisdiction of this controversy under 28 U.S.C. § 1331.

3. Venue is proper in this judicial district pursuant to 28 U.S.C. § 1391(e).

PARTIES

4. Plaintiff The Chesapeake and Potomac Telephone Company of Virginia ("C&P") is a corporation incorporated under the laws of the Commonwealth of Virginia

and is a wholly-owned subsidiary of Bell Atlantic Corporation, a publicly held company with over one million shareowners. C&P is in the business of providing telephone service in, among other places, the City of Alexandria, Virginia, and is a "common carrier" within the meaning of section 533(b) of the Cable Act.

5. Plaintiff Bell Atlantic Video Services Company ("BVS") is a corporation incorporated under the laws of the Commonwealth of Virginia and is a wholly-owned subsidiary of Bell Atlantic Corporation. BVS was incorporated for the purpose of providing video programming in, among other places, the City of Alexandria and is affiliated with C&P within the meaning of section 533(b) of the Cable Act.

6. Defendant United States of America is a party to this action.

7. Defendant Federal Communications Commission ("FCC") is a federal agency created by Congress pursuant to the Communications Act of 1934 (47 U.S.C. §§ 151 *et seq.*) and is charged with enforcement of section 533(b) and other regulation of cable television pursuant to 47 U.S.C. §§ 401 and 521 *et seq.*

8. Defendant William P. Barr, named in his official capacity as Attorney General of the United States of America, is charged with enforcement of section 533(b) pursuant to 47 U.S.C. § 401.

Background

9. In 1984, Congress passed the Cable Communications Policy Act, 47 U.S.C. §§ 521 *et seq.* ("Cable Act"), which among other things prohibits telephone companies and their affiliates from providing video programming within the areas where they provide telephone service. Section 533(b) of the Cable Act provides in relevant part as follows:

> (b)(1) It shall be unlawful for any common carrier, subject in whole or in part to subchapter II of

this chapter, to provide video programming directly to subscribers in its telephone service area, either directly or indirectly through an affiliate owned by, operated by, controlled by, or under common control with the common carrier.

(2) It shall be unlawful for any common carrier, subject in whole or in part to subchapter II of this chapter, to provide channels of communications or pole line conduit space, or other rental arrangements, to any entity which is directly or indirectly owned by, operated by, controlled by, or under common control with such common carrier, if such facilities or arrangement are to be used for, or in connection with, the provision of video programming directly to subscribers in the telephone service area of the common carrier.

10. The Cable Act defines "video programming" as "programming provided by, or generally considered comparable to programming provided by, a television broadcast station." 47 U.S.C. § 522(16).

11. Under section 533(b), it is unlawful for C&P and BVS, as affiliates, to provide video programming directly to subscribers in areas where C&P provides telephone service. It is also unlawful for C&P to provide channels of communications to BVS for use in provision of video programming in these areas.

COUNT I

SECTION 533(b) IS UNCONSTITUTIONAL ON ITS FACE UNDER THE FIRST AMENDMENT

12. The allegations of paragraphs 1 through 11 are incorporated herein by reference.

13. Video programming is a form of speech protected by the First Amendment of the United States Constitution. Video programmers own, produce, select, assemble,

package, and distribute images, ideas, information, opinions, and entertainment.

14. The video programming prohibition in section 533(b) of the Cable Act is, on its face, an unconstitutional prior restraint on speech.

15. The prohibition is, on its face, a straightforward ban on certain types of constitutionally protected expression. The prohibition is directed at speech itself and therefore requires strict scrutiny.

16. Under the statutory definition of "video programming," 47 U.S.C. § 522(16), the applicability of the restriction necessarily turns on the content of telephone companies' speech. Congress has required government officials to decide whether telephone companies are providing prohibited speech that is "generally considered comparable to" television broadcast programming or whether they are providing non-prohibited speech which may also involve video images. This statutorily required process of official authorization, therefore, involves an evaluation of the video images and the context in which they are to be presented; a consideration of the impact such video images will have upon the viewer; and a determination whether such video images will be perceived by the general public as a substitute for the forms of video speech that have been provided by others over traditional cable and broadcasting facilities. All of the foregoing involves the government in an investigation of content. Consequently, the statutory prohibition is content-based and must be subject to strict scrutiny.

17. Section 533(b) is a speaker-specific restriction on protected expression that singles out speech provided by telephone companies and imposes a special and targeted prohibition on that speech in particular. Strict scrutiny is therefore warranted.

18. Section 533(b) is an audience-specific restriction on protected expression that prevents telephone companies from providing video programming only to subscribers

within their telephone service areas. Strict scrutiny is therefore warranted.

19. Section 533(b) violates both the First Amendment right of telephone companies to provide video programming and the First Amendment right of subscribers to receive the video programming which plaintiffs and other telephone companies would provide.

20. The government defendants, which bear the burden of justifying this infringement of First Amendment rights, cannot prove that section 533(b) is necessary to serve any compelling governmental interest or even any substantial or important governmental interest.

21. The speech targeted by section 533(b)—television shows, movies, sports, news, and political reporting and opinions—is not unlawful.

22. In enacting section 533(b) in 1984, Congress stated that it was seeking to prevent the development of "local media monopolies." This objective has not been achieved. In 1992, in enacting the Cable Television Consumer Protection and Competition Act, Congress found that "[t]he cable industry has become highly concentrated. The potential effects of such concentration are barriers to entry for new programmers and a reduction in the number of media voices available to consumers." Congress found that "[t]he average monthly cable rate has increased almost 3 times as much as the Consumer Price Index" since 1986. "[M]ost cable television subscribers have no opportunity to select between competing cable systems. Without the presence of another multichannel video programming distributor, a cable system faces no local competition. The result is undue market power for the cable operator . . . ."

23. The government defendants themselves have found that section 533(b) is now hindering the objectives it was originally intended to promote:

a. In 1988, defendant FCC tentatively concluded that the prohibition "no longer serves the public interest." In

1992, on a full administrative record, the FCC found that the prohibition should be repealed. Repealing the prohibition would "increas[e] competition in the video marketplace, spur[] the investment necessary to deploy an advanced infrastructure, and increas[e] the diversity of services made available to the public." Separately, the FCC reported to the President that introducing competition from telephone companies "would result in significant price savings for consumers and stimulate provision of a range of new information services. Current experience with head-to-head competition in cable markets indicates that rates would fall about 20% for the entire video package; if competition is introduced nationwide, subscribership would likely expand by 11.2 million households."

b. Defendant Barr in his official capacity as Attorney General stated that "[t]elevision viewers will be best served by removing barriers to entry by new firms into the video services marketplace. The Administration, therefore, supports removal of current legislative prohibitions against telephone company provision of video programming, with appropriate safeguards." The Department of Justice, acting under the supervision of defendant Barr, stated that telephone companies "should be allowed to own and directly provide video programming" because telephone company "provision of video programming will have procompetitive benefits that outweigh any anticompetitive risks involved."

24. The defendants to this action further have concluded that any valid governmental concerns can be addressed by means that do not prohibit telephone companies and their affiliates from video programming.

25. Despite their concessions that the video programming prohibition is not necessary to any governmental interest, defendants have indicated that they will continue to enforce the prohibition. Consequently, there is an actual and justiciable controversy between the parties.

26. Plaintiffs, as well as consumers who are being denied the right to receive video programming which plaintiffs and other telephone companies would provide, have no adequate or complete remedy at law to redress the denial of their First Amendment rights other than by seeking the relief sought in this action. Unless defendants are enjoined from enforcing section 533(b), plaintiffs and consumers will continue to suffer substantial and irreparable harm.

COUNT II

SECTION 533(b) IS UNCONSTITUTIONAL AS APPLIED UNDER THE FIRST AMENDMENT

27. The allegation of paragraphs 1 through 26 are incorporated herein by reference.

28. If permitted to proceed, C&P and BVS will provide video programming in the City of Alexandria, Virginia. C&P will enhance its telephone network in Alexandria to have the capability of carrying several hundred channels of video programming. In addition, C&P's network will have the capability to deliver video programs on demand, which will allow consumers to select programs from video libraries. C&P's affiliate, BVS, will provide some of the video programming on the network, and the network will also be available for use by other video programmers on a common carrier basis.

29. Plaintiffs are ready, willing and, but for defendants' enforcement of section 533(b), able to provide video programming to Alexandria. Consumers in Alexandria want to receive this programming. As a result of the defendants' continued enforcement of section 533(b), both plaintiffs and consumers will continue to suffer substantial and irreparable harm. Plaintiffs have no adequate or complete remedy at law to redress the denial of First Amendment rights other than by seeking the relief sought in this action.

30. Although section 533(b)(4) of the Cable Act provides that the FCC may in particular circumstances waive

the video programming prohibition for "good cause," this waiver provision is inadequate to protect the plaintiffs' and consumers' right to free speech and is itself a violation of the First Amendment. Congress provided no standards or time limits by which the FCC must grant or deny a "good cause" waiver, but instead admonished the FCC that this "waiver authority should be narrowly construed." The FCC itself has not adopted any standards or time limits. As a result, the FCC has unbridled discretion in determining whether and when, if ever, a "good cause" waiver may be granted.

31. As applied to the facts and circumstances of the video programming services that plaintiffs would provide in Alexandria, section 533(b) violates plaintiffs' right of free speech under the First Amendment, as well as the First Amendment right of consumers in Alexandria to receive plaintiffs' video programming.

COUNT III

SECTION 533(b) VIOLATES EQUAL PROTECTION BOTH ON ITS FACE AND AS APPLIED

32. The allegations of paragraphs 1 through 31 are incorporated herein by reference.

33. Section 533(b) is a legislative classification that interferes with the plaintiffs' exercise of the fundamental right of freedom of speech. Section 533(b) discriminates against telephone companies that wish to provide video programming while permitting other, similarly situated entities to engage in this activity.

34. Section 533(b) does not apply at all to other regulated utility companies, including utilities owning poles and conduits, that are permitted to provide video programming in their service areas.

35. Section 533(b) also does not apply to the cable TV companies which Congress found have "undue market power." As interpreted by the FCC, section 533(b)

applies only in one direction: against telephone companies that seek to provide video programming, and not against cable TV companies that seek to provide telephone service. Cable TV companies and their affiliates are taking advantage of this one-sided prohibition by providing long distance telephone services, cellular radio services, personal communications services, competitive access services, and other telephone services in the same areas where they provide video programming.

36. Section 533(b)'s discrimination against telephone companies is not necessary to serve any compelling governmental interest.

37. Section 533(b) violates the equal protection principles embodied in the Fifth Amendment to the United States Constitution, both on its face and as applied to the video programming that plaintiffs would provide in Alexandria.

38. Plaintiffs have no adequate or complete remedy at law to redress the denial of their Fifth Amendment rights other than by seeking the relief sought in this action. Unless the defendants are enjoined from enforcing section 533(b), plaintiffs will continue to suffer substantial and irreparable harm.

COUNT IV

SECTION 533(b) VIOLATES PLAINTIFFS' RIGHTS TO USE THEIR PROPERTY FOR EXPRESSION

39. The allegations of paragraphs 1 through 38 are incorporated herein by reference.

40. Plaintiffs propose to use the existing C&P telephone network, together with certain enhancements, to provide video programming in Alexandria.

41. Section 533(b) violates the rights of plaintiffs to harness their property's potential for constitutionally protected expression, in violation of both the First and Fifth Amendments.

PRAYER FOR RELIEF

WHEREFORE, plaintiffs pray that the Court enter an Order:

1. Declaring that section 533(b) of the Cable Act is unconstitutional, void, and unenforceable on its face as a violation of the right to free speech guaranteed by the First Amendment to the United States Constitution;

2. Declaring that section 533(b) of the Cable Act is unconstitutional, void, and unenforceable under the First Amendment to the United States Constitution as applied to plaintiffs' provision of video programming in Alexandria;

3. Declaring that section 533(b) of the Cable Act is unconstitutional, void, and unenforceable as a violation of the right to the equal protection of the laws under the Fifth Amendment to the United States Constitution;

4. Declaring that section 533(b) of the Cable Act is unconstitutional, void, and unenforceable under the First and Fifth Amendments to the United States Constitution as a violation of plaintiffs' rights to use their propery for expression;

5. Permanently enjoining defendants from enforcing section 533(b) of the Cable Act in any criminal, civil, or administrative proceedings; and

6. Granting plaintiffs such further relief as the Court may deem just and equitable.

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA and BELL ATLANTIC VIDEO SERVICES COMPANY, By Counsel

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Dated: December 17, 1992

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA

(Caption Omitted in Printing)

ANSWER

Defendants United States of America, the Federal Communications Commission (the "FCC," or "Commission") and Stuart M. Gerson, in his capacity as Interim Acting Attorney General,[1] answer plaintiffs' Complaint for Declaratory Judgment and Injunctive Relief, dated December 17, 1992 (the "Complaint"), as follows:

First Defense

Plaintiffs lack standing to sue.

Second Defense

The Court lacks jurisdiction over Count IV of the Complaint.

Third Defense

Plaintiffs have failed to exhaust their administrative remedies.

Fourth Defense

The Complaint fails to state claims for which relief can be granted.

Fifth Defense

The relief sought by plaintiffs is not authorized by law.

---

[1] Pursuant to Rule 25(d)(1) of the Federal Rules of Civil Procedure, Mr. Gerson, in his official capacity as Interim Acting Attorney General, is automatically substituted as a defendant herein for William P. Barr.

Sixth Defense

The equitable relief sought by plaintiffs is barred because they have an adequate remedy at law.

Seventh Defense

Defendants respond to the numbered paragraphs in the Complaint as follows:

1. The first sentence of paragraph one states a conclusion of law to which no response is required. Sentence two contains plaintiffs' characterization of this action, to which no response is required. As to sentence three, deny that defendants have stated that 47 U.S.C. § 533(b) ("Section 533(b)") does not "serve any valid governmental purpose"; the remainder of sentence three purports to characterize *Television Company-Cable Television Cross-Ownership Rules: Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking*, 7 FCC Rcd. 5781 (1992) (the *"Second Report and Order"*), the April 1, 1992 letter from former Attorney General William P. Barr, and former Commerce Secretary Barbara H. Franklin, to Hon. Edward J. Markey, Chairman, Subcommittee on Telecommunications and Finance, House Committee on Energy and Commerce (the "Markey letter"), and *Telephone Company-Cable Television Cross-Ownership Rules: Reply Comments of the United States Department of Justice*, dated March 13, 1992 (the *"Justice Reply Comments"*), to all of which this Court is respectfully referred for a full and accurate statement of their contents. Admit sentence four.

2-3. Admit.

4. Defendants lack sufficient information or knowledge to form a belief as to the truth or falsity of the first sentence of paragraph four. Admit the second sentence.

5. Defendants lack sufficient information or knowledge to form a belief as to the truth or falsity of paragraph five.

6. Admit.

7. Admit that the Commission is an agency of the Federal Government created by 47 U.S.C. § 154, and is charged by the Communications Act of 1934, 47 U.S.C. § 151 *et seq.*, with the enforcement of Section 533(b).

8. Admit that the Attorney General of the United States is charged with the enforcement of Section 533(b) pursuant to 47 U.S.C. § 401 and other statutory provisions.

9. As to sentence one, admit that in 1984 Congress passed the Cable Communications Policy Act, 47 U.S.C. § 521 *et seq.* The remainder of sentence one states a conclusion of law to which no response is required. Sentence two purports to set out the provisions of Section 533(b)(1) and (b)(2), to which the Court is respectfully referred for a full and accurate statement of its contents.

10. Paragraph 10 purports to set out the provisions of 47 U.S.C. § 522(16), to which the Court is respectfully referred for a full and accurate statement of its contents.

11. Paragraph 11 states conclusions of law to which no response is required.

12. Defendants incorporate herein by reference their responses to paragraphs 1-11 of the Complaint.

13. Sentence one states a conclusion of law to which no response is required. Plaintiffs' use of the term "video programmers" is too vague and ambiguous for defendants to form a belief as to the truth or falsity of sentence two.

14-21. Paragraph 14-21 state conclusions of law to which no response is required.

22. Sentence one purports to characterize H.R. Rep. No. 549, 95th Cong., 2d Sess. (1984), *reprinted in* 1984 U.S. Code Cong. & Admin. News ("U.S.C.C.A.N.") 4655, to which the Court is respectfully referred for a full and accurate statement of its contents. Deny sentence two. Sentences 3-8 purport to characterize the Cable Television Consumer Protection and Competition Act of 1992, P.L. 102-385, 106 Stat. 1460 (the "1992 Act"), § 2, to which

Act the Court is respectfully referred for a full and accurate statement of its contents.

23. Deny sentence one. As to paragraph 23(a): Sentence one purports to characterize the Commission's tentative decision in *Television Company-Cable Television Cross-Ownership Rules: Further Notice of Inquiry and Notice of Proposed Rulemaking*, 3 FCC Rcd. 5849 (1988), to which the Court is respectfully referred for a full and accurate statement of its contents. Sentences two and three purport to characterize the Commission's *Second Report and Order* (*see* ¶ 1, above), to which the Court is respectfully referred for a full and accurate statement of its contents. Sentences four and five purport to characterize the Report of the Federal Communications Commission Regarding the President's Regulatory Reform Program, dated April 28, 1992, to which the Court is respectfully referred for a full and accurate statement of its contents.

As to paragraph 23(b): Sentences one and two purport to characterize the Markey letter (*see* ¶ 1, above), to which the Court is respectfully referred for a full and accurate statement of its contents. Sentence three purports to characterize the *Justice Reply Comments* (*see id.*), to which the Court is respectfully referred for a full and accurate statement of its contents.

24. Paragraph 24 purports to characterize the Commission's *Second Report and Order* and the *Justice Reply Comments*, to which the Court is respectfully referred for a full and accurate statement of their contents.

25. As to the first sentence, admit that defendants will continue to enforce Section 533(b); otherwise, deny. The second sentence states a conclusion of law to which no response is required.

26. Paragraph 26 states conclusions of law to which no response is required.

27. Defendants incorporate herein by reference their responses to paragraphs 1-26 of the Complaint.

28. Defendants lack sufficient information or knowledge to form a belief as to the truth or falsity of paragraph 28.

29. To the extent the first sentence of paragraph 29 is intended as a statement of fact, defendants lack sufficient information or knowledge to form a belief as to its truth or falsity. To the extent it is intended to state a conclusion of law, no response is required. Defendants lack sufficient information or knowledge to form a belief as to the truth or falsity of sentence two. Sentences three and four state conclusions of law to which no response is required.

30. Sentences one and two of paragraph 30 state conclusions of law to which no response is required. Deny sentence three. Sentence four states a conclusion of law to which no response is required.

31. Paragraph 31 states a conclusion of law to which no response is required.

32. Defendants incorporate herein by reference their responses to paragraphs 1-31 of the Complaint.

33-34. Paragraphs 33-34 state conclusions of law to which no response is required.

35. Sentence one states a conclusion of law, to which no response is required, and also purports to characterize the 1992 Act, § 2, to which the Court is respectfully referred for a full and accurate statement of its contents. Sentence two states a conclusion of law to which no response is required. Plaintiffs' use of the term "[c]able TV companies and their affiliates" is too vague and ambiguous for defendants to form a belief as to the truth or falsity of sentence three.

36-38. Paragraphs 36-38 state conclusions of law to which no response is required.

39. Defendants incorporate herein by reference their responses to paragraphs 1-38 of the Complaint.

40. Defendants lack sufficient information or knowledge to form a belief as to the truth or falsity of paragraph 40.

41. Paragraph 41 states a conclusion of law to which no response is required.

The remainder of the Complaint is plaintiffs' prayer for relief, to which no response is required, but to the extent a response is deemed necessary, defendants deny that plaintiffs are entitled to the relief requested therein, or to any relief whatsoever.

Defendants specifically deny any and all allegations of plaintiffs' Complaint not otherwise answered herein.

WHEREFORE, having fully responded to the Complaint, defendants pray that this action be dismissed and that the Court grant such other and further relief as may be appropriate.

Dated: February 12, 1993

Respectfully submitted,

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FCC POLICY ON CABLE OWNERSHIP: A STAFF REPORT

CONCURRING STATEMENT

of

COMMISSIONER JOSEPH R. FOGARTY

In Re: Issuance for Public Comment of FCC Staff Report on Cable Cross-Ownership Policies

I concur in the Commisison's decision ordering that the Report of the FCC Office of Plans and Policy staff on cable cross-ownership policies be issued for public comment. It should be emphasized, however, that the staff report is just that—a *staff* report—and at this point does not enjoy Commission approval.

In my view, the staff report presents a decidedly mixed bag of policy assessment and pronouncement. I have the same fundamental difficulty with this report that I had with its predecessor on Direct Broadcast Satellite policy: [1] proposed finding of abundant program diversity and assumptions of "workably competitive" markets in video technology and services must be supported by pragmatic fact as well as general economic theory. In finding that a "workably competitive" video media market now exists, the staff report's analysis lumps existing broadcast outlets and cable systems together with subscription television (STV), muti-point distribution systems (MDS), direct broadcast satellites (DBS), low power television, VHF drop-ins, video cassettes and video discs. It is far from clear, however, that cable television service is interchangeable with over-the-air broadcast television service. This substitutability issue is critical to the validity of the

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[1] *Notice of Inquiry into the Development of Regulation Policy in regard to Direct Broadcast Satellites for the Period following the 1983 Regional Administrative Radio Conference*, Docket 80-603, 45 F.R. 72719 (November 3, 1980), Separate Statement of Commissioner Joseph R. Fogarty.

staff report's policy recommendations and warrants full public comment. It also appear to me to be little more than wishful thinking to predicate a finding of "workable competition" on new technology and services (e.g., DBS, Low Power TV, and fledgling STV and MDS) which are more on the horizon than with us here and now. In the final analysis, this Commisison must have more than merely the *assumption* of a "workably competitive" marketplace as the basis for policy making.

In addressing the specific issues of broadcast television station-and network-cable cross-ownership, the staff report does make certain observations which deserve serious consideration. The report may be correct when it suggests that such cross-ownership may in fact *increase* diversity in both economic and First Amendment terms. In this regard, I agree that while a cable system could control a substantial share of the total video outlets in a community, the relevant policy question is not "How would a cross-owned system behave," but "Would its performance or that of the co-owned broadcast station deteriorate under cross-ownership?" It may be, as the staff report suggests, that natural profit-making and investment incentives, as well as oversight and pressure from the local franchising authority, make it unlikely that cross-owned systems would be any less dedicated to the fullest possible development of cable's potential.

I also think that the staff report is excellent in its discussion of the benefits of vertical integration which may be lost to consumers as a result of overly-restrictive Commission ownership rule and policy.[2] The price to be

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[2] While it is refreshing to see this acknowledgment of the benefits of vertical integration in the context of an assessment of cable ownership policies, it is regretable that this sensitivity has not been more manifest in other areas of Commission "deregulatory" endeavor. *See Computer Inquiry II, Final Decision*, Statement of Commissioner Joseph R. Fogarty, Dissenting in Part, 77 FCC 2d 504, 508-511 (1980). The degree of structural separation prescribed by the *Final Decision* for the dominant carrier subsidiary's pro-

paid for a reflexive anti-cross-ownership policy may be not only diminished diversity but no service at all.[3] In the final analysis, it is the result, and not the theory, that counts.

While the staff report purports to be responsive to these pragmatic principles in its recommendations regarding broadcast television station-and network-cable cross-ownership, it unfortunately balks at the consistent application of those principles to the telephone company-cable cross-ownership issue. Although the report acknowledges that considerable benefits of vertical integration would inhere in such cross-ownership, it nonetheless argues for retention of the existing prohibition based on the assumption that cable may become a direct competitor of the telephone company's local loop and local exchange services. While the report concedes that this competitive scenario is speculative, it insists that rescission of the cross-ownership prohibition would be "irreversible" in terms of forfeiting whatever benefits of inter-modal com-

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vision of customer premises equipment and enhanced services reflected an analysis in which

> "all assumptions pertaining to the benefits of separation are treated as givens whereas any countervailing arguments pertaining to the benefits of vertical integration are treated as unproven hypotheses subject to considerable doubt."

Id. at 508.

[3] This observation has proved all too true with regard to the impact of the cable-telephone company cross-ownership prohibition on the provision of cable service to rural America. While the Commission has now adopted an outright exemption from the cross-ownership ban for telephone company rural cable service, *Elimination of the Telephone Company Cable Television Cross-Ownership Rules for Rural Areas*, —— FCC 2d —— (Adopted Nov. 5, 1981), cable service that could have been provided to rural America by telephone companies was long denied in favor of protecting a vague future possibility of service from independent operators. *See, id.*, Separate Statement of Commissioner Joseph R. Fogarty and other Statements cited at n. 1 *supra*.

petition might occur as a result of future independent cable system development.

I have previously stated my opposition to the telephone company-cable cross-ownership prohibition [4] and will not repeat those views in full detail here. However, I think the line of argument in the staff report borders on hallucination. It is inanely wishful thinking to suggest that in the foreseeable future independent cable system operators will install the switching equipment and capacity necessary to duplicate and compete with the local telephone exchange. In terms of either economics or technological demand and investment, the staff report's scenario is sheer fantasy.

The staff report's "irreversibility" argument is even more troublesome for sound analysis and policy. The decision which will be "irreversible" here—and perniciously so—is the one recommended by the staff: the continued and perhaps permanent foreclosure of telephone company participation and competition in the broadband telecommunications marketplace. Indeed, continuation of the prohibition on telephone company-cable cross-ownership will seriously retard, if not completely preclude, the introduction and deployment of broadband, fiber-optic technology in the local telephone exchange. It will be the American consumer who will suffer the loss of telecommunications benefits directly attributable to this myopic policy recommendation.

New and evolving fiber optic telecommunications technology offers the potential for economic replacement of copper wire with glass fiber as the transmission medium in the local loop of the telephone exchange. This potential is enhanced as research and development continues to lower both the cost and signal attenuation of fiber

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[4] *Revision of Processing Policies for Waivers of Telephone Company—Cable Television "Cross Ownership," On Reconsideration*, Separate Statement of Commissioner Joseph R. Fogarty, 82 FCC 2d 266 (1980).

optics. The ability of fiber optic cables to handle wide-band signals has made fiber optics an ideal transmission medium for high capacity digital data links. This capacity for wide-band signals is certain to be highly useful in other telecommunications applications.

As we enter the Information Age, the need to move large amounts of data among geographically disparate points becomes imperative and acute. Our consumption of wide-band information in the diverse forms of audio, video, and data signals will grow dramatically. It is technically feasible for a single optical fiber to replace the existing network of coaxial cable and copper wire pairs, not only providing telephone and video service to homes but also the delivery path for many additional services. This Commission may not be able to "foster" the obvious public interest benefits of fiber optic technology, but we should certainly recognize an obligation not to get in the way. As I observed in an earlier separate statement on telephone company-cable cross-ownership:

> [T]he Commission must . . . confront the possibility that the prospect of merging fiber optic technology with the local loop of the telephone exchange may offer "natural monopoly" economies in the provision of broadband facilities and services which a sound and rational policy analysis cannot ignore. If these economies emerge in significant magnitude, then telephone company competition in the cable television marketplace may be "unfair" only in the sense that it may be inherently unbeatable. If this should prove to be the case, the hard but necessary answer may have to be that the public interest is better served by such unfairness.*

I find it depressing that the staff report fails to deal seriously and rationally with this critical issue of tech-

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* 49 FCC 2d 966, 973.

nological and competitive foreclosure. While other countries have been experimenting successfully with optical fiber home connection,[6] there is no apparent active interest in applying fiber technology to the local loop in the United States. Given the constraints and disincentives embodied in the Commission's cross-ownership rules, it is not surprising that despite their service, technological, and investment capabilities, U.S. telephone companies have been reluctant to engage in substantial fiber optic research and development for the local loop. What is surprising—and also reprehensible—is that the agency of the U.S. Government charged with telecommunications oversight should be the perpetrator of this comparative disadvantage to the detriment of our national public interest.

The staff report purports to cope with this regulatory insanity by recommending that the Commission look with favor on telephone company waiver applications propos-

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[6] In 1978 the first visual information system employing fiber optic technology was completed in Japan. The Japanese system offers 158 subscribers a number of video signals, still pictures, and textual material and demonstrates the feasibility and practicability of using fiber optic technology in the field. HI-OVIS Project Interim Report-Hardware/Software Experiments, July 78-March 79, VISDA MITI Juridical Foundation, Tokyo, Japan, September 1979. In the same year, 1978, Bell Canada installed fiber optic cables at 86 of its subscribers' residences in Toronto, Ontario. Telephone, FM radio, and video services are offered over this Canadian system. P. Chouinard et al., "Description and Performance Review of the Yorkville Integrated Service Fiber Optic Trial," Conference Digest, ICC 1979. The French PTT is sponsoring a large scale trial of fiber optics technology in Biarritz, France. By the end of 1982, the first few of what will ultimately be several thousand subscribers will have access to a complete range of services, including television and telephone, all supplied via a fiber cable. M. Trebeux and E. LeCocquil, "Multi-Services Optical Network," National Telecommunications Conference Record, 1980. For a general information survey of these and additional fiber optic local loop experiments, see R. J. Wills, "Subscriber Loop Applications of Fiber Optics," Conference Records, Electro 1981.

ing "innovative cable or telephone technologies that require joint operations." This proposal is a classic case of too little too late. As this Commission's new "unregulatory" philosophy so insistently observes in other areas, the very existence and fact of regulation erects significant barriers to technological development and investment. Given the abominable history of this Commission's administration of a "waiver process" for telephone company provision of cable service to rural America,[7] and a reviewing mentality that sees the omnipresent spectre of "cross-subsidy" lurking in cable service provided by rural telephone co-operatives,[8] a promise of a possible waiver for "innovative" proposals will not provide the regulatory certainty required for multi-million-dollar telephone industry investments in local loop fiber optic research, development, and deployment. Nothing short of complete repeal of the telephone company-cable cross-ownership prohibition will do, and the national public interest demands no less.

I am hopeful that the Commission—if not also its staff—is prepared to act with intelligence and a sense of reality. Anti-competitive regulation in the guise of pro-competitive policy has ruled this area long enough for us to asceratain the detrimental results. I look forward to a rulemaking proceeding to eliminate this pernicious prohibition—the sooner the better.

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[7] *Elimination of the Telephone Company-Cable Television Cross-Ownership Rules for Rural Areas*, Separate Statement of Commissioner Joseph R. Fogarty, —— FCC 2d —— (November 5, 1981).

[8] *Id.*

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FCC POLICY ON CABLE OWNERSHIP

A Staff Report by

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November 1981

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF PLANS AND POLICY
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Part I

Chapter 1

Introduction and Summary of Conclusions

A. *Origin and Scope of The Study*

In October 1980 the Federal Communications Commission directed its staff to study the Commission's rules on ownership of cable systems.[1] Five issues were to be examined.[2] The first was the rule barring the cross-ownership of cable systems by a telephone company serving the same area.[3] This investigation considers cable-telco crossownership generally and goes beyond other recent Commission investigations and rulemakings on crossownership.[4] The second issue was whether to allow the ownership of many local cable systems by the same company. Multiple system operators (MSO's) are a prominent feature of the cable industry.[5] Currently, the Commission has no rules limiting the number of systems an MSO may operate. The third issue was whether cross-ownership between television stations and cable systems within the Grade B broadcast contour should be per-

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[1] See FCC News Release, October 22, 1980. The proceeding from which this study emanated is CC Docket No. 78-219. The instant concern of the Commission was with waiver policy standards for rural cable-telephone company cross ownership (see 47 CFR 63.55). Since the rural issue is being examined elsewhere in the Commission (CC Docket 78-219) we do not cover it in this study.

[2] Since that time questions have also arisen about the desirability of foreign ownership of cable. An examination of the issues presented in foreign ownership is under way, and its conclusions will be available to the Commission in the fall of 1981.

[3] 47 CFR 63.54.

[4] CC Docket 78-219.

[5] See Chapter 6, *infra*.

mitted.[6] The fourth issue was the prohibition against cable ownership by the major commercial networks.[7] The fifth issue was "separations," *i.e.*, whether cable operators should manage their facilities as pipelines, leasing some or all of their channels on a non-discriminatory basis to those who wish to transmit programming or other services.[8]

B. *Organization of the Study*

The issues examined in this report all concern cable ownership policies.[9] Each raises distinct (albeit occasionally overlapping) policy issues, however, and affects different interests. As a result there are five distinct reports in the overall study, to facilitate use by readers interested in less than ownership policy in general.

The final section of this chapter is a summary of the basic conclusions and policy recommendations of the entire study. Detailed support for the positions presented appears in the chapter corresponding to each issue.

Part II of the study provides information important for an understanding of each of the ownership issues examined. Therefore Chapters 2 and 3 are intended to be

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[6] 47 CFR 76.501.

[7] *Ibid.*

[8] This suggestion was strongly supported in The Cabinet Committee on Cable Communications, *Report to the President*, 1974 (The Whitehead report). The case for separations has been made in terms of enhancing access, not economic competition. Separations still has some support, but has not been an active issue recently. See Stanley M. Besen and Robert W. Crandall, "The Deregulation of Cable Television," 44 *Law and Contemporary Problems* at 120-121 (Winter, 1981).

[9] Separations policy is indirectly related. See *Report to the President* (*supra*, n. 7) for the argument that at least some of the media crossownership prohibitions are unnecessary in the presence of a separations policy. (Recommendation 3, at 31-33.) This conclusion is not extended to telephone companies, however. (See Recommendation 4, at 33-34).

read in conjunction with any or all of the chapters that deal with the specific ownership issues in Part III.

Chapter 2 contains background on the cable industry. The basic technical characteristics of cable are outlined and recent developments likely to affect cable's "capabilities" are reviewed. A brief historical survey of the industry, including the effects of regulation on cable development, is provided. Finally, the chapter examines in some detail the various markets that cable serves or has the potential to serve, and identifies the sources and nature of competition in these markets. Some discussion of related markets, such as programming supply, that might be affected by cable ownership rules is included.

Chapter 3 presents general issues about ownership rules or a separations requirement for cable. The meaning of consumer welfare, in various dimensions, is explored in an attempt to provide an understanding of the benefits and costs of the present rules and of proposed changes in those rules. More specifically, the chapter begins by examining the economic aspects of consumer welfare, including the question of what forces determine the services provided by cable, how they are produced, as well as how they are distributed—that is—who gets them. Paralleling the economic concerns are considerations of First Amendment rights and their relation to cable access. The latter issue is also analyzed in Chapter 3 and is linked to the economic aspects of ownership policy.

Part III of the report contains the chapters that analyze each of the five issues and provide support for specific policy recommendations. When read in conjunction with Part II of the report, each chapter may be used by itself.

Chapter 4 covers the broadcast-cable crossownership prohibition. Chapter 5 examines the growth of multiple system operators (MSO's) to determine whether or not the growth of large firms within the cable industry itself

presents problems that the Commission should address. Chapter 6 covers the crossownership issue for the three commercial television broadcast networks.

Chapter 7 examines the advantages and disadvantages of a separations policy for cable. Although separations (severing the link between the ownership and operation of a cable system and the determination of what services it carries) is not an ownership policy as such, proponents have argued it may eliminate some of the problems associated with crossownership.

Finally, Chapter 8 examines the telephone-cable crossownership problem. A number of special features, including rate of return regulation, ownership of pole and conduit space, and a local switched service monopoly position characterize the telephone system and raise problems not shared by other cases of crossownership.

Throughout, the report attempts to minimize the use of technical economic terms and arguments. Except where absolutely central to the discussion, such arguments have been placed in the footnotes or, in cases where the treatment is both technical and extended, in an appendix.

C. *Summary of Conclusions*

We find that the underlying goals of the Commission's ownership policies—the promotion of competition in the economic marketplace and in the marketplace of ideas—are met when a wide range of media, both video and non-video, is available. Our analysis suggests that the market for video programming and many of the other services that cable can provide is workably competitive [10] and in most cases not susceptible to monopolization. We see little danger arising from horizontal control, either

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[10] See Chapter 3 for a discussion of this term. The Commission has, from time to time, found it relevant to assess the competitiveness of submarkets such as video program delivery or radio services.

in local video markets or in national markets (*i.e.*, the franchising and programming markets) associated with cable.[11] Therefore, we believe that in general a policy extending free entry into cable to all interested firms is most likely to contribute to a rapidly growing, technologically dynamic industry that meets consumers' needs. Consumers' preferences can best determine what cable firms provide, and the incentives of entrepreneurs are more likely to shape an efficient industry structure than a predetermination by government policy-makers. Changes in the structure of the mass communications industry since the cable ownership rules were adopted have removed whatever need the Commission once saw for such rules. These changes will have even more impact in the future.

Therefore, we make the following specific recommendations:

(1) The rule that prohibits broadcasters from owning cable systems in their own areas should be rescinded.[12]

(2) The provisions in that rule that prohibit cross-ownership of cable by the major commercial networks should also be dropped.[13]

(3) The Commission should not place any limitations on the number of cable systems a multiple system operator may own or on the number of subscribers it may serve.[14]

We are aware that some cases of market power may exist or that unforeseen problems may arise in the future.

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[11] Horizontal control refers to the ability to directly affect the price and other terms of exchange in a particular market.

[12] 47 CFR 76.501. See Chapter 4.

[13] *Ibid.* See Chapter 6.

[14] At the current time there is no rule on how many local cable systems a single firm may control. The issue is discussed in Chapter 5.

These do not appear to be so numerous, so comprehensive, or so likely that either comprehensive prohibitions such as the cross ownership rules, or flat numerical restrictions on ownership, are desirable. Rather, reliance on enforcement of the anti-trust laws can remedy those few situations that are unacceptably lacking in competition. In this fashion the cable industry will be free to shape itself in the patterns that best meet the differing needs of individual markets, and consumers will obtain the benefits of an efficient industry organization.

Because most of the markets in which cable operates are workably competitive,[15] because the cable industry is still in a stage of rapid growth and experimentation, and because cable entrepreneurs have strong incentives to respond to and provide for the overall needs of cable consumers, we conclude that cable operators should retain the primary responsibility for determining what cable programming and other services should be available on their systems. Therefore:

(4) We recommend that the Commission *not* enact a separations requirement for cable operators in most circumstances. An exception to this conclusion would arise in the event of telephone company ownership, and is discussed below.[16]

Cable operators do not now exercise total control over what is carried over their facilities. FCC rules mandate carriage of all significantly viewed local broadcast signals, and local franchise authorities can and do require cable operators to provide a wide variety of facilities, services and program options as a condition of the franchise. Even more important than these requirements are the profitmaking pressures on the operator for providing a

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[15] This term is defined in Chapter 3, at page 33. See n. 9.

[16] See recommendation (5) on page 8. The general issue is expored in Chapter 7.

high quality, diverse, and reasonably priced set of offerings to consumers.

Revisiting the separations question would be appropriate should cable become the means by which of a substantial majority of communications services is provided. At present a monopoly outcome seems far from certain. Therefore, we recommend no general separations policy.

Finally, we believe that, for the most part, the same conclusions about TV markets reached in connection with broadcasters, networks and MSO's apply to telephone ownership and operation of cable systems. But in the market for non-video services, the potential for effective competition is less imminent.

Elimination of the cable-telephone crossownership ban before there is some likelihood of competition (or at least potential competition) for local loop services would seriously limit consumer alternatives.[17] While cellular, XTEN, and perhaps other technologies offer potential completion in local services, their future roles remain uncertain. In addition, cable crossownership now may add significantly to the difficulty of achieving cost based telephone rates. We would like to stress that these problems are a consequence of the exclusive franchise, rate base regulated nature of the telephone industry and do not stem from cable.

Although the objective of deregulation is to allow the marketplace to provide the services desired by consumers, this goal requires freedom of entry by potential suppliers. In most local telephone and cable markets, free entry does not now exist. Therefore deregulation of crossownership is not yet possible. We do believe, however, that as long as the services people desire are provided at reasonable cost, it should not be the role of government to select the organization that provides them. Thus the crossownership ban may not always be necessary. Two

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[17] The term "local loop" refers to the pair of copper wires that connects each telephone subscriber to the central office or switch.

developments could ease the problem: (1) competition for the local loop could arise from new technologies or (2) as narrowband cable technology stabilizes it may become possible to insure access to, and competition in that narrowband technology. In these circumstances cross-owned systems may become feasible. Chapter 8 describes such a regime (separations), and explains why it cannot be relied upon to protect competition given the present state of technological knowledge.

We are mindful, however, of the expertise the telephone company may be able to bring to cable development. If the crossownership ban were to retard technological change in either industry, the cost to consumers might be high over the long run. Therefore, the Commission should be flexible in granting waivers from the crossownership ban whenever either a telephone or a cable company proposes an experiment that requires closely integrated cable-telephone operations.

Finally, leaseback arrangements, which are currently available, but not extensively used, could provide a route for taking advantage of any economies resulting from joint operations.

In sum we further recommend that the Commission:

(5) Retain the basic features of the current cable-telephone crossownership ban,

(6) expand and encourage the use of leaseback arrangements to take advantage of whatever joint economies may be available,

(7) expand and encourage the use of waivers of the rule when applicants propose innovative cable or telephone technologies that require joint operation, and

(8) continue to monitor both competitive and technological developments that may make possible ending the ban entirely.

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Chapter 8

Telephone Ownership of Cable

A. *Introduction*

Telephone companies and cable systems both provide electronic information services over wire. Many services can be provided by either one. With adequate switching and consumer premises equipment cable companies can do just about anything that a telephone company can. With some changes in telephone systems, telephone companies can do virtually anything that a cable company can.[1] The potential for competition with the local telephone monopoly is central to arguments to ban cross-ownership of cable and telephone facilities and joint operation of these facilities.[2]

To encourage flexibility in the provision of new services and to protect cable interests, the Commission has ruled that a local telephone company may not operate a cable system in its service area. Other reasons for the ban that were cited by the Commission in its crossownership prohibition are the possible cross-subsidy between cable

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[1] See *USITA Member Letter* (April 20, 1981), for a description of a cable applicant which is applying to provide telephone service. Because twisted pair wire used for telephone signals is narrowband, it cannot carry video transmission of the quality necessary to allow television signals without significant cross-talk problems. Segregation of digital carrier systems can allow the telephone company to provide high speed data and even video transmission over existing local loop between cable and plant telephone facilities. (See "New technique could allow video transmission over phone lines," *Bell Laboratories Record*, 503-503, October 1980.) New telephone technologies, especially local use of fiber optics may eliminate any remaining distinctions.

[2] Several other technologies are potential competitors in the provision of local service. These include private microwave (XTEN), cellular radio, satellite, and others. Whether these services become competitive depends on cost considerations and may also be affected by Commission decisions.

and telephone services; the argument that cable is an "infant industry," which can develop fully only if protected from telephone control; and the problems rising [*sic*] from telephone companies' ability to deny access to independent cable systems through control over poles and conduits.[3] The prohibition on crossownership is waived only in cases where cable service could not otherwise be provided, or where "other good cause" [4] can be shown.

Because of the high fixed costs and low variable costs of cable provision, cable facilities are likely to be provided by a single firm. This situation is reinforced by state and local franchise regulations. Therefore, if telephone ownership of cable facilities becomes prevalent, it is unlikely that a competitive cable system will develop. While there are a number of competing sources of entertainment broadcasting,[5] there are currently few substitutes for local telephone service.

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[3] To a large extent, the two last problems have been eliminated or reduced by the development of the cable industry and by legislation. The cable industry has grown rapidly in recent years; it is no longer appropriate to think of it as an infant. Likewise, pole attachment legislation has given independent cable operators recourse if the telephone company is limiting access to poles at reasonable rates.

[4] Clear and substantial economies in construction or operation are defined as satisfying the "other good cause" criterion in the Sugar Land Report and Order (76 F.C.C. 2d 230 (1980)).

[5] See the preceding chapters. These alternatives include over-the-air broadcasting, DBS, MDS, STV, movie threaters, live theater, live sports events, newspapers and magazines, and other entertainment and information activities. See, also the *Staff Report on Policies for Regulation of Direct Broadcast Satellites* 11-32. This argument has two logical consequences. First, as technologies that can compete with telephone company services are developed, the need for cross-ownership restrictions is reduced; second, if cable does not develop these two-way services (i.e., if it does not become an actual or viable potential competitor with the telephone company in basic telephone services), many prospective benefits arising from the ban will not develop.

Section B of this Chapter discusses the advantages of crossownership. Section C examines the disadvantages of crossownership. Section D considers several alternative regulatory policies including (1) dropping the ban upon appropriate state regulation; (2) a regulatory approach that relies on cost manual type cost allocation and on a "partial separations" policy for telephone company owned cable systems; and (3) maintaining the present ban. We conclude that the ban must be retained for the time being.

The Commission now bans crossownership and operations between CATV systems and telephone companies in the same service area.[6] Telephone companies however, are allowed to own and operate cable systems outside of their own service areas and may also own cable facilities if they are leased back to an independent cable system.[7]

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[6] Final Report and Order 21 FCC 2d 307 (1970).

[7] The ban is contained in the Final Report and Order, 21 FCC 2d 307 (1970). Under the order, independent cable systems must be allowed the option to construct their own facilities; the telephone company cannot force them to accept a telephone company owned facility. In practice, the lease-back of telephone company provided facilities has been uncommon. (Thus at present only 12 telephone companies post lease-back tariffs). One reason for this scarcity however, may be a Commission effort to discourage telephone company ownership of cable facilities.

While the Commission did not specifically find that anti-competitive behavior existed, it argued "that the prevention of such possible abuses fully warrant our policy findings herein, and the new rules which will implement them." (21 FCC 2d at 329, 1970).

While the Commission banned cable-telephone crossownership in general, it admitted that in some areas cable service may be possible only if provided by a telephone company and that in these instances an application for waiver of the crossownership rules would be considered.

Because the waiver process is costly and the standards on which waivers were to be granted were unclear, the Commission has broadened the waiver standards for rural areas. It now presumes that crossownership is necessary if sparsely settled areas are to receive cable services. On November 29, 1979, the Commission instituted

B. *Advantages of Crossownership*

1. *Background*

The 1970 *Report and Order* bans crossownership between cable and telephone facilities because of the potential dangers. Crossownership, however, may also offer benefits. Joint construction and operation may lower engineering, construction, maintenance, or operations costs. If these savings are large enough, then the prohibition on crossownership is costly and should be continued only if the ban results in clearly offsetting benefits. Our society

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a waiver presumption policy in jurisdictions with population densities of less than thirty homes passed per cable mile. 81 FCC 2d 233.

This general waiver policy allowed crossownership between cable systems and the local telephone company within its franchise area. On October 9, 1980, the Commission defined the area within which the thirty homes per mile measure is to be applied as the cable franchise area (because of the likelihood of gerrymandering) 86 FCC 2d 254, but it reversed this decision on reconsideration, and decided that the service area is the appropriate standard for determining the waiver presumption. (46 *Fed. Reg.* 31418, June 16, 1981). It argued that it could control gerrymandering on a case by case basis.

The presumption retains the preference in favor of independent operation of cable and telephone systems. Thus, the policy allows for rebuttal of the presumption by a cable company's demonstration that it will serve the area itself.

The telephone company/cable television rule may also be waived "upon showing of good cause." *See* Section 63.56(a) of the Commission rules, 47 C.F.R. § 63.56(a). In this regard, the Commission has stated that:

> The right of a telephone company to attempt to meet that high burden is not automatically cut off by the possibility of independent CATV operation in the area. This burden will not be met, however, by a telephone company's merely showing a possible marginal advantage in joint operation over independent operation. 76 FCC 2d at 235-6.

Even though the Commission recently proposed eliminating the ban in rural areas (*See Notice of Proposed Rulemaking in CC Docket No. 80-767*, 84 FCC 2d 335 (1981)), the general prohibition on crossownership in more populated regions has been little modified since its adoption in 1970.

preserves a bias in favor of allowing firms or individuals to enter any markets they wish. Those seeking to prohibit crossownership must make a affirmative case that there are strong social interests in keeping certain firms out. It is not sufficient to argue that the advantages of cross-ownership are small.

Telephone and cable systems are likely to maintain separate facilities (at least in the short run) because of technical differences between cable and telephone operations. This is especially true where telephone or cable plant is in place.[8] In areas of rapid population growth, substantial additions to telephone stock and construction of new cable systems could be undertaken jointly if costs would be lowered by doing so. For example, coaxial cable could be used for transmission of both telephone and wideband communications.[9]

2. *Economies*

Even if different transmission equipment is used to carry narrowband and wideband communications, some economies could be realized in construction by lashing together coaxial cable and paired wire.[10] Such physical integration might be costly where separate companies own

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[8] While some telephone equipment exists almost everywhere, development of new towns or rapid suburban growth may result in instances where the existing telephone facilities are totally inadequate and substantially new equipment must be constructed.

[9] See, for example, Rural Electrification Administration, "The Economics of Rural Telephone and CATV Integration," August 22, 1977. Most of the advantages cited here, however, relate to the lower cost of capital faced by telephone companies. In that article, the lower cost of capital was due to subsidies from the federal government through the Rural Electrification Administration.

[10] While lashing makes economic sense where the proportion of cable and loop plant is known in advance, in practice this decision is likely to differ for each use. If so, many of the potential economies evaporate.

each facility. Companies may be concerned about damage done to their own facility in the course of work done by the other company. Some economies in repair and other work could be achieved through coordination. Such coordination is likely to be difficult to organize if one company believes that it will benefit from delays suffered by the other company (i.e., where they provide competing services).

There may be other economies of joint construction. Common conduits and poles are frequently used to provide cable and telephone services. Substantial savings may be realized if cable can be laid at the same time as telephone wire (especially if cables are buried). The labor required to wire customer premises may be reduced if cable hookups and telephone attachments are provided by a single crew. A combined company is more likely to take the demands of both systems into account in planning the type of poles used and the delivery technology.[11] If cable demands are not taken into account, increased costs will result from incorrect spacing, moving electric wires, etc. Economies also may be realized through joint maintenance. When wires are damaged by storm or accidents, it may be possible to send one crew to restore both telephone and cable service.[12] Likewise simultaneous repairs of cable damage in underground conduits may be far less costly than separate repairs.

If cable and telephone services are offered by one company, fixed administrative and overhead costs will be

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[11] A telephone company could take potential cable demands into account without crossownership. Regulation may make it unwilling or unable to do so.

[12] "A Study of the Technical and Economic Feasibility of Providing Narrowband and Broadband Communications Services in Rural Areas: Executive Summary" BNR INC., Palo Alto, California, August 1978 argues that telephone repair personnel must be retrained before they could undertake such joint repairs. Such retraining would be wasteful in areas where specialized crews could be fully employed, and where travel costs are low.

spread more widely. Costs of billing can be reduced, and consumer convenience increased, by using a single mailing. Combined operations might allow hiring of specialists that neither company could afford on its own. Even in large systems, division of labor may be increased by crossownership.[13] Finally, in small companies the total number of managers might be reduced by joint ownership, and entrepreneurial skills might be more fully employed.

Some argue that increased telephone involvement in cable provision might result in service being extended to new areas faster.[14] If telephone companies can realize the economies discussed above, they may be able to operate where an independent cable system can not.[15] Telephone companies already have access to public right-of-way [*sic*] and experience in negotiating with local regulatory boards. To some extent this access represents a real social savings since a telephone company will be able to avoid costs that the cable company would have to endure. On the other hand, if the telephone company is awarded a cable franchise through favoritism rather

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[13] Large telephone exchanges seem likely to take advantage of these economies as they typically specialize very highly. (In general, the availability of consultants willing to work on a part time basis will reduce the need to expand in order to increase specialization of labor.)

[14] Thus, Commissioner Joseph Fogarty has argued "[i]t is time for the Commission to question whether our existing rule and waiver standard impose too great a burden on today's consumers in terms of foregoing cable service which can be provided *now* by telephone companies in favor of vague *future possibility* of service by independent operators." Separate Statements of Joseph R. Fogarty in 82 FCC 2d, 254.

[15] Telephone companies also may be able to shift profits from regulated telephone operations. This possibility (discussed below) raises an entirely different set of issues. A telephone company might wish to enter a market even if it is not the lowest cost provider of service if entering this market allows it to evade regulation.

than because it will provide the best possible service, the result could be inefficient.

Telephone companies typically have better access to capital than do cable companies. Rural telephone companies, especially cooperatives, have historically been able to obtain low cost government loans.[16]

Rural Electrification Administration loans and loan guarantees are generally made for the purpose of encouraging nationwide telephone service. Neither Congress nor the Commission has explicitly determined that nationwide rural cable service is in the public interest or that it must be subsidized by anyone.[17]

Telephone companies also may be able to introduce service more rapidly than independent cable companies because of their knowledge about consumers demographic, financial, or geographic patterns. This type of information allows real cost savings, and must, therefore, be considered a potential advantage of crossownership.[18]

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[16] Rural Electrification Administration "The Economies of Rural Telephone and CATV Integration" August 22, 1977. A low cost government loan does not reflect real economic savings. Since this is the case, the use of government funds for the provision of cable service to rural areas when this service is provided by telephone companies is questionable. Therefore, the advantage that telephone companies may have in attaining low interest loans through the REA cannot be considered to be a real economic advantage of telephone company provision of cable service.

[17] Nationwide telephone service is an important goal of the Commission and Congress. Neither Congress nor the Commission has formally determined that universal nationwide availability of cable, at the non-compensatory prices that are likely to be required to bring this about, is justified. As this report emphasizes, many of the services that cable provides can also be provided over other media or technologies. Translators can provide rural video coverage at a far lower cost than cable. There thus appears to be no reason to assume that nationwide cable availability need be a national goal. Congress has, however, provided some funding for rural cable systems through REA and the Rural Development Act of 1972 Pub. L. No. 92-419, §§ 109 & 118, 86 Stat. 659, 663-4 (1972).

[18] This information could be sold to an independent cable system. Again, the real advantage of allowing the telephone company

Finally, allowing telephone companies to compete increases the number of qualified bidders for cable franchises. While there are already many bidders for most non-rural cable systems, telephone companies have extensive engineering know-how, some of which could be applied to cable.[19] Telephone companies are already allowed to operate cable systems outside of their telephone service areas; therefore some of these economies could be gained without any changes in Commission policy. Nevertheless, consumers might benefit if telephone companies were able to bring specific expertise about conditions in their own service areas to cable.

The advantages of crossownership discussed so far revolve around potential coordination between the cable and telephone entities. Far more important advantages may result if crossownership leads to technological advances in the cable or telephone industries. Likewise, crossownership has very high costs if its stifles technological advances.

3. *Technological Progress*

Crossownership could either limit or encourage the development of communications technologies. Technological progress potentially has greater long run significance

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to provide cable service is the avoidance of transactions cost rather than the loss of information.

[19] Not all of a telephone company's engineering experience can be easily transferred to cable. In addition to the obvious technical differences between narrowband and wideband communications channels, the degree of reliability that is typically built into telephone systems is far higher than that typically required of cable. (See "A Study of the Technical and Economic Feasibility of Providing Narrowband and Broadband Communications Services in Rural Areas, Executive Summary," BNR INC., Palo Alto California, August 1978.) A one wire system designed to the reliability standards set for telephone service would be more expensive than a coaxial system where less reliability could be tolerated. Thus, the advantage of a one-wire system, even where the system is to be created *de novo*, might be minimal or nonexistant.

for consumer welfare than any of the economies of joint ownership that we have considered.

If crossownership significantly accelerated the development of new technologies or services, this would be a powerful argument in favor of dropping the ban. Conversely, if advances would be retarded, this would be a strong reason for retaining the ban. A prediction of the direction of this effect would be valuable, but such predictions are difficult to make, and crossownership is likely to affect technological advances in more than one way.

A crossowned system might have more incentives to innovate because it would be able to utilize fully any new techniques developed in either service.[20] Independent provision might mean that technological advances would be under-utilized or even inapplicable (because, for example, these advances rely on a "one-wire" type system or might have to be shared with another firm).

The counter-argument is that there will be less innovation if competitive pressures do not compel the firm to seek lower costs and better techniques.[21]

Evidence on the conditions that foster technological progress in other industries is ambiguous.[22] Moreover, the evidence that is available does not indicate how local market dominance will affect innovation in the presence of nationwide competition for those local services.

To the extent that joint technological progress in the telephone and cable areas is embodied in physical capital, lease-back arrangements of the sort already described

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[20] This may be overcome by lease-back agreements.

[21] Rate-of-return regulation may also hamper telephone company innovation since the innovating telephone company would not be allowed to enjoy the profits that its innovation would allow.

[22] F. M. Scherer *Industrial Market Structure and Economic Performance*, Second Edition, (Chicago: Rand McNally College Publishing Company, 1978) at, 407-438. The markets Scherer discusses are not regulated markets. Regulation may have a stifling effect on innovation.

might allow any new economies to be realized. Nevertheless, where risk and uncertainty of outcome are high, such contractually arrangements may be inadequate vehicles for cooperation between telephone and cable companies.

The crossownership rules do allow waivers for "other good cause." Good cause is defined to include cost economies attainable through new technology. (See footnote 4, *supra.*) Therefore, present rules allow telephone companies to reap many of the benefits of technological improvements that they can offer cable.

The existence of potential economies may not be sufficient to compel cooperation, however. For one thing, the cable system may feel that its chances of franchise renewal are better if its owns the cable facility itself. Likewise, the danger of cable rate regulation may be higher where telephone company owned facilities are used by the cable company.[23]

The development of technology is unpredictable. The Commission should be prepared to allow crossownership for experimental systems that attempt to apply new technology to cable. Such a waiver policy would not endanger the incentives to progress generated in both the telephone and cable industries by the increasing range of competition between these systems, but would allow

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[23] Contracting costs are likely to be high if the cable and telephone companies believe themselves to be supplying essentially the same service. Especially since the telephone company is subject to rate of return regulation, it may wish to exclude its competitor rather than suffer competition. Likewise, if the telephone company believes that it may be permitted to enter cable in the future, it is less likely to wish to encourage independent cable operation. Finally, the costs of reaching an agreement are generally nonzero. Even if the telephone and the cable companies wished to cooperate and believed that there is no essential conflict between their goals, it may still be cheaper for one company to undertake both projects and avoid the inevitable differences that combined operation will present.

progress from joint operations when that seems likely to occur.

4. *Conclusion*

There are some potential advantages to joint ownership of telephone and cable facilities. At a minimum, the degree of cooperation and coordination between these services will be higher where they are operated jointly. Moreover, joint ownership may encourage discovery or use of new techniques that reduce the costs of service.[24]

Our discussion of the potential advantages of crossownership is necessarily somewhat theoretical. There are three reasons for this. First, the crossownership prohibition has been strictly enforced;[25] thus the data on possible economies in urban areas are severely limited. Second, there have been dramatic changes in the nature of the cable business over the past several years. Third, the existing cost advantages or disadvantages of the tele-

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[24] Some observers believe that improvements in fiber optic communications technology will ultimately make an integrated wideband delivery system using fiber "loops" to the home the most efficient means of delivering voice, data, and video services. (See E. J. Claire, C. Richard Patisaul, and J. C. Wyatt, "Broadband Fisher-Optic Systems: Designs for Now and Near Future," *Communications News*, September 1978, pp. 72-73 and R. Kachulak, "A Rural Integrated Distribution Trial with Fiber Optics," *IEEE Communications Magazine*, January 1981, p. 36.) Some preliminary field trials have already been conducted in foreign countries. Some of these are described in the following Institute of Electrical and Electronics Engineers' conference record papers: R. J. Mills, "Subscriber Loop Applications of Fiber Optics," *Electro* 1981; P. Chouinard, et. al., "Description and Performance Reviews of the Yorkville Integrated Service Fiber Optic Trial," *International Communications Conference*, 1979; and M. Treheux and E. LeCoquil, "Multi-Services Optical Network," *National Telecommunications Conference*, 1980.

[25] Furthermore, the 1956 Consent Degree (see section C-4 below) has heretofore precluded AT&T, the largest telephone company, from provision of cable television services.

phone company are probably less important than the dynamic cost economies that interaction between cable and telephone service may be able to offer. While the economies from joint construction may be small where the telephone plant is already constructed, in the future, whenever new telephone facilities are needed or old facilities must be replaced, far more substantial economies may be realized.

Cost economies need not be proven as a condition for crossownership. Rather, the market should be relied on unless this will lead to problems that cannot be dealt with without government interference. The problems that crossownership may entail, and suggested means for dealing with them, are the subjects of the following sections.

As we argued above, there is a presumption that firms should not be prevented from entering markets. Those who wish to argue against crossownership should be expected to make a strong case. The fact that economies of joint operation may generally be low is not a sufficient argument to ban crossownership. Nevertheless, the following section argues that there are major problems associated with unrestricted crossownership.

C. *Disadvantages of Crossownership*

1. *Introduction.*

The disadvantages of crossownership largely derive from the fact that telephone companies are regulated exclusive franchise monopolists in their local area. These disadvantages can be classified into four groups.

First, crossownership may allow a telephone company partially to avoid rate-of-return regulation on its telephone service. It can do so by attributing costs to the regulated telephone division and revenues to an unregulated cable division.[26]

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[26] J. B. Duvall and M. D. Pelcovits discuss this problem in the case of private line telecommunications services, which they argue

Second, cable service can compete with telephone services in the areas of alarm systems, data transmission, meter reading, and even plain old telephone service. Telephone companies may be able to forestall this facilities based competition in two-way communications by owning the cable system. Crossownership or cooperative operations will also allow joint-monopoly profit maximization.[27]

Third, the size of some telephone companies relative to the cable industry could allow one or two telephone companies to gain a very large share of the national market in cable.[28]

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can be deregulated. ("Reforming Regulatory Policy for Private Lines Telecommunications Services: Implications for Market Performance", Office of Plans and Policy Working Paper Number 4, December 1980.) The problem is considerably smaller in that case since private line service is a nationwide telephone offering, and since there exists an interim cost allocation manual to prevent this type of cost-shifting. A major policy difference between the use of cost allocation for deregulation of private line services and for control of cross-owned cable systems is that private line services are already provided with joint or common facilities. This is not the case with cable facilities, but might become the case if crossownership is allowed.

[27] Joint-monopoly profit is the profit earned by two firms acting as a single monopolist. Such cooperation is likely to lead to greater monopoly profits than would competitive behavior. This joint-profit maximization is constrained. Alarm systems can be independent of both cable, and telephone; XTEN type service or direct satellite service like that provided by SBS may eventually offer reasonable substitutes for phone or cable data services. Nevertheless, the use of a satellite for local transmission is not likely to be effective or cheap. Interactive alarm systems are likely to be more reliable than are stand-alone systems, and electronic meter reading is likely to be cheaper than having meter readers check meters several times a day. Therefore some market power is likely to remain.

[28] See *Comments of the National Cable Television Association, Inc.* in CC Docket 80-767 (at. 34-39) (1981).

Fourth, telephone companies control substantial conduit and pole space. Unrestricted control over cable access can give the telephone company a powerful lever to gain control of the cable system or to charge monopolistic rates for access. Rate or pole price regulation can limit exploitation of telephone company monopoly power unless crossownership is allowed.[29]

2. *The Allocation of Costs*

Effective rate-of-return regulation may make it profitable for telephone companies to undertake enterprises that would be unprofitable in the absence of regulation. If telephone companies arbitrarily allocate costs to regulated facilities and revenues to unregulated facilities, they may partially avoid the rate-of-return limitations that regulation attempts to impose. If the telephone company bases a large part of its behavior on avoiding regulation, the most efficient organization of production is unlikely.

Telephone regulation determines an allowable rate of return and permits the telephone company to earn this return on allowed capital, after allowed expenses. As long as regulation effectively limits the telephone company's rate of return, the company has an incentive to attribute costs to the regulated sector. If cable crossownership allows regulated telephone companies to shift

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[29] Rate regulation gives two motives for crossownership. First, even if the industries were non-competitive, crossownership may enable the telephone company to attribute cable costs to the telephone company rate base or telephone companies revenues to the cable subsidiary. Second, if the cable system and the telephone companies are natural competitors, crossownership allows joint profit maximization and joint monopoly pricing. Because the telephone company supplies a vital commodity to the cable (pole attachments), it could charge a high enough price to absorb most of the cable profits itself and force the cable to charge the joint monopolistic prices to be able to pay for the input. Since it is rate regulated, the telephone company can keep these profits only if they can be attributed to a cable subsidiary.

costs, a powerful incentive toward crossownership (stronger than and in addition to the incentive to increase capital discussed by Averch and Johnson [30]) is created.[31]

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[30] H. Averch and L. Johnson "Behavior of the Firm Under Regulatory Constraint", 52 *American Economic Rev.* 1053-69 (December 1962). Averch and Johnson discuss distortions caused by rate regulation over the entire entity. Thus, if a telephone company can claim certain capital expenditures as part of the rate base, it may wish to undertake this investment even if it adds nothing to sales or to the attractiveness of the output. When part of the entity escapes regulation, any costs generated in the unregulated sector that can be shifted to the regulated sector represent pure profits.

[31] Assume, for example, that both a telephone company and a cable system can be supported by a community, that the capital stock of the telephone company is $100 million, and that the capital cost of a cable company is $50 million. Make the further simplifying assumption that operating costs are zero for both the telephone and cable operation (all costs are capital costs), that the allowed rate of return is 10 percent, and that a protected telephone monopolist would earn 20 percent if rate regulation were totally ineffective. In this example, each dollar of cable costs that can be attributed to the telephone system will justify a ten cent per year increase in allowed telephone revenue, up to the monopoly level. If all cable costs can be attributed to the telephone system, but all cable revenues can still be attributed to the cable sector, the telephone company could raise its telephone price by 50 percent and earn a 15 percent real rate of return on actual telephone capital. This assumes that the regulatory commission is willing to allow rate increases and that it believes the telephone company's attribution of cable facility costs to the telephone company rate base. If the regulatory commission refuses to grant rate increases for political reasons, the incentives for misallocation of costs are reduced. Such a regulatory policy is of dubious legal or economic value since it may preclude new investment and because it may not allow the recovery of real costs. Depending on the ability of the telephone company to allocate cable costs to telephone operations, very significant increases in apparent telephone revenue requirements may be possible without any change in the underlying costs. When costs can be shifted, the value of the cable system to the telephone company is substantially greater than it would

When costs can be shifted, rate of return regulation may make joint ownership of cable and telephone facilities profitable to the telephone company even if joint provision of cable and telephone service is more costly than independent provision.

This rationale for a crossownership ban is dependent on the assumption that rate of return regulation has held telephone rates below the monopoly level (though not necessarily below the level that could result from competition and contestability), and that the regulators respond to higher costs by allowing higher rates. If regulators ignore reported costs and set rates on other grounds (such as a simple inflation adjustment to historical rates), the incentive to shift costs would likewise vanish, although other problems would develop.[32]

Current Commission regulation limits crossownership only within the telephone service area.[33] As long as costs can be attributed geographically, the current ban appears sufficient to eliminate this danger of crossownership.[34]

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be to an independent cable company. The value of a cable system to the telephone company will thus equal the sum of the present value of cable profits plus the present value extra telephone company profits generated through cost-shifting.

[32] In general, inflation type adjustments will bear no necessary relationship to changes in costs of telephone inputs. Thus adjusting rates on the basis of inflation may allow excess profits or profits that are insufficient to allow the recovery of investments. Legally such a strategy is very questionable as it might amount to confiscation prohibited under the Fourteenth Amendment.

[33] (21 FCC 2d at 325. (1970)).

[34] This assumes that telephone companies are not able to shift costs when they own cable facilities and lease them to independent cable operators (which is currently allowed). Since most cable operators have chosen to construct their own cable facilities, the effectiveness of local regulatory commissions in determining the assignment of costs has not been tested. It should be noted that the incentives of telephone companies to misstate costs are far less when they must lease the cable facilities to an independent

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Such cost shifting will be far harder to control if cable and telephone system costs are incurred in one area for the same types of equipment, or are to some extent joint or common.[35]

One of the most difficult aspects of telephone regulation is the assignment of costs to their causes. Cable and telephone systems share a certain amount of capital equipment;[36] allocating shared costs between these capital accounts on the basis of actual cost causation will be difficult or impossible. (See footnote 35 supra.) Maintenance and general overhead costs are difficult to apportion between systems.[37] Regulators cannot simply compare costs facing joint cable telephone systems with costs in independent systems in other areas. Both cable and telephone facilities differ across regions; special geographic or demographic factors may cause substantial differences in cost and total costs of combined systems may differ from independent costs. No simple yardstick is available.

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operator than when they can own an unregulated cable subsidiary. As long as the cable company is independent, any lease revenues fall under rate of return regulation, but if the cable company is owned by the telephone company, the cable can be charged low rates and show high profits outside of rate regulation.

[35] Joint costs are shared costs that must be borne regardless of the proportion of the goods produced (like overhead). They involve no tradeoff between the goods. Thus their allocation cannot be based on supply characteristics alone. Common costs are shared costs that involve tradeoffs, and so can be assigned on the basis of use without economic distortion.

[36] Typically cable and telephone systems share poles or conduit space.

[37] Ramsey pricing theory (see, for example, E. E. Zajac *Fairness or Efficiency: An Introduction to Public Utility Pricing*, (Cambridge, Massachusetts: Ballinger Publishing Company, 1978) sets price in a way to recover full costs, and is implicitly, therefore, an economic theory of shared cost allocation. In practice, however, more arbitrary means of allocation must be selected.

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Problems of cost-shifting cannot be ignored since the Commission is responsible for ensuring that rates are cost-based. The problems of cost-shifting may not be insurmountable. The Commission may be able to deregulate one part of a telephone company operation without deregulating the remainder.[38] Nevertheless, this possibility depends on an effective cost separations mechanism at minimum. No such mechanism currently exists to separate cable costs from telephone costs; a major regulatory proceeding would be required to develop and implement one. Further, both accounting and engineering staff would be hard pressed to apply such a cost allocations manual, even if one could be devised.

Section D.4 of this chapter argues that a well designed separations policy[39] someday may be able to limit the incentives of the telephone company to shift costs from the cable entity to its telephone business. Nevertheless, if the Commission were to permit crossownership, it might simply have to accept a certain amount of cost-shifting.[40]

3. *Potential Competition*

Cable and telephone suppliers can already compete in the provision of many two-way services. Where cable is inde-

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[38] Pelcovits and Duvall make this argument. (See n. 25 *supra*). They are discussing an already regulated service. It might be costly to extend regulation to a new area.

[39] See chapter 7, for a discussion of separations policy in the general cable context.

[40] If the Commission decides to allow crossownership, it will shift a substantial responsibility onto state regulatory commissions (PUCs). It may, therefore, wish to consider removing the crossownership ban only when the state PUC asks it to do so. That is, the interests of the local franchise board may be in conflict with the interests of the state PUC. Because the PUC will be forced to determine cost allocation, its interests must be considered. This is not to say that the Commission must decide to allow crossownership if the state PUC wishes. A substantial part of local costs are reflected in the interstate revenue requirements, and therefore come under the Commission's jurisdiction.

pendently owned, the threat of cable entry into two-way markets may restrict the ability of the telephone company to behave as a monopolist. If the facilities were jointly owned, this constraint would not exist. Telephone companies have other actual competitors and potential competitors; nevertheless, cable has more potential to provide telephone-like services in the near future than does any other carrier.

Cable systems provide competition with the local telephone company both in two-way services and in access to the increasingly competitive interstate telecommunications market. In some cities, for example, Satellite Business Systems (SBS) proposes to rely on cable facilities for origination and termination of some of its transmissions.[41] Without competitive access to the local consumer, the potential for interstate competition is limited.[42]

The problems of cost-shifting are present in any telephone company expansion into service areas; in the cable area the likelihood that potential competitors will be eliminated is even more serious. Cost-shifting is a result of monopoly and of partially effective regulatory control. If potential competition or actual competition is prevalent, cost-shifting will be highly limited.

Cable systems are not the only possible competitors for local loop type service. The appearance of other entrants would reduce the need for cable competition to constrain telephone company market power. Some argue that competition in local loop facilities could develop rapidly,

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[41] *See M/A-Com, Inc., Annual Report* at 14-16 (1980). See also "Belt-Tightening Gotham to Use Manhattan Cable for Data Sending," *Variety* at 42 (July 8, 1981).

[42] In this case, the difference in potential damages from high levels of AT&T involvement in the provision of cable services (as opposed to other telephone companies) becomes important. AT&T is the dominant carrier in interstate carriage as well as in local service. Because of this, it has more reason to wish to monopolize local loop services than would an independent telephone company.

and that the traditional bottleneck could be circumvented.[43] If new technologies fulfill their promise, the need for ownership restrictions may be eliminated. Nevertheless, at present the ability of these new technologies to provide competition with the full range of telephone services, if they develop at all, remains largely speculative. Cable has more immediate prospects for providing some competitive services, and long run prospects for eliminating the "local bottleneck" altogether.[44] The local monopoly held by telephone companies and the ability of cable to provide similar services, not any special attributes of cable entertainment, makes telephone control over the cable medium undesirable.

4. *Special Issues Involving AT&T*

Much of the opposition to cable-telephone crossownership is motivated by a fear of AT&T.[45] AT&T serves most of the larger metropolitan areas; these areas have become most attractive for cable systems. AT&T's sheer size, its nationwide operations, and its vertically integrated nature raise serious concerns about Bell entry into new industries.[46]

This Report argues that cable concerns are largely local. A telephone company, whether AT&T or the smallest independent, has extensive market power in its fran-

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[43] See, for example, D. N. Hatfield "Local Distribution—The Next Frontier," presented before the Ninth Annual Telecommunications Policy Research Conference, Annapolis, Maryland, April 29, 1981. These new technologies include independent cellular radio, and microwave radio technology such as XTEN.

[44] *Ibid.*

[45] See NCTA *Comments, supra.*

[46] The issues of nationwide cable provision by a single entity have already been discussed in Chapter 5 of this report. It was argued that nationwide cable coverage by a single entity may be undesirable. Nevertheless, the way to deal with that problem is not to maintain cable-telephone company crossownership rules, but to address the problem of cable concentration directly.

chise areas. AT&T differs from an independent telephone company because AT&T has more extensive capital resources than any independent telephone company markets and because AT&T's Long Lines division is the dominant interstate carrier. Recent interpretation of the 1956 Consent Decree[47] makes it unclear whether AT&T would continue to be restraint from entering the cable market.[48] Limits on AT&T may be further modified by Congress. The National Cable Television Association (NCTA) has argued that under AT&T's proposed interpretation of the decree, Bell would be allowed to enter the cable market.[49]

If the consent decree does not prohibit Bell entry into cable, the Commission should treat Bell like any other telephone company unless it can specify special circumstances that justify the difference in treatment. The size differential by itself is not central. Both Bell and independent telephone companies have much the same incentive to enter cable; protection of their local monopoly power. Because cable provides competition to local facilities, concerns about local monopoly and access to interstate services should be the concerns that guide Commission policy.

5. *Restricting Access*

The Commission cited the ability and apparent willingness of telephone companies to deny access to independent cable companies as one justification for the crossownership ban.[50]

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[47] *U.S. v. Western Electric et. al.*, Consent Judgment, January 24, 1956, U.S. District Court for New Jersey, 13 RRLN3; 1956 Trade Cases 71, 134.

[48] U.S. v. Western Electric Inc., and American Telephone and Telegraph Company, U.S. District Court for the District of New Jersey Civil No. 17-49, September 5, 1981.

[49] NCTA *comments, supra*, pp. 49-50.

[50] 1970 *Report and Order* (21 F.C.C. 2d) at 308, 323-324.

Power to deny access takes several forms. Of most immediate concern is telephone company ownership of poles to which cable may be attached and conduit through which cable may run. The Commission has authority (under the Pole Connection Act) to "regulate the rates, terms, and conditions for pole attachments" except where a state assumes regulatory responsibility.[51] In spite of this law, cable companies argue that problems of access remain substantial.[52]

The problem of pole access does not by itself justify banning crossownership. If the telephone company were allowed to sell access to independent cable companies it could, in principle, develop a price schedule that exactly exhausted all cable monopoly profits and transfer these to the telephone company with no loss in consumer welfare.[53] Unless a telephone company believed it was able to achieve lower costs through direct ownership, it would be content to charge high prices for independent access. Where cable and telephone companies offer competitive services, however, access pricing could be used to reduce the cost of acquiring cable companies (by reducing cable profitability and hence the value of the system). The telephone company, therefore, would jointly operate cable and telephone facilities to maximize total profits.

The ability of telephone companies to control access means that lease-back agreements must be carefully scru-

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[51] Cable Connection Act, P.L. 95-234. As of January 28, 1981, 19 states plus Puerto Rico, had assumed responsibility for regulating pole attachments.

[52] Their arguments are three. First, the pole attachment statute expires five years after its enaction, i.e., in 1983; second, many states have preempted federal authority without providing an adequate substitute; and third, the enforcement process is sufficently slow that pole access remains a substantial barrier. (See, for example, NCTA *Comments supra* at 13-14.

[53] See the discussion of vertical integration in Appendix B.

tinized. Where telephone companies have control over access, they may have the incentives and ability to force cable systems into lease-back agreements. By doing so, they may be able to limit cable competition.

The pole attachment rules constrain the ability of telephone companies to abuse control over access. Because of this, the Commission should look on lease-back tariffs, where both the telephone company and the cable company are agreed on the rates and terms, with little reservation. With the controls already in place, lease-back would enable the telephone system and cable operators to enjoy many or all of the benefits of crossownership. The Commission should not allow telephone companies to force lease-back on cable franchise owners; it also should not, however, preclude their use.

6. *Conclusion*

The problems involved in cable-telephone crossownership are sufficient to overcome the social presumption in favor of allowing unrestricted crossownership.[54] Cable sys-

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[54] This is not to say that the Commission should not continue its rural waiver program. Where cable service would not be otherwise provided, or where there will be a serious time lag between implementation of cable service by the telephone company and an independent cable company, the competitive advantages of independent cable operation are not available. If the Commission is willing to allow the state and local governments to worry about cost allocation problems (despite the fact that these problems spill over into interstate rates), the Commissions waiver process is quite reasonable. This is also not to say that the Commission must continue to impose its regulations until non-cable technologies competitive with local telephone services develop. If cable systems do not develop their two-way facilities in competition with local loop telephone company facilities but instead concentrate on the broadband entertainment market to the exclusion of all else, the ban serves little purpose and should be eliminated. The belief that cable systems can compete with telephone company appears to be justified by recent developments in the cable industry. The

tems provide a viable substitute to many telephone services. Allowing crossownership could eliminate this growing competition. This does not mean that the present ban *must* be continued or if it is continued, that it must always be maintained. In particular, increasing competition from other substitute services may make it unnecessary. At present three options seem likely: (1) the Commission can attempt to develop a regulatory policy to encourage competitive provision of services even where the facility is owned by a telephone company (the partial separations approach discussed below is an example of such a policy); (2) the Commission can retain its current ban on crossownership but institute more flexible waiver and lease-back arrangements; or (3) the Commission can retain its present ban, but allow individual states to claim jurisdiction over crossownership.

Development of competition in local distribution would reduce the need for crossownership restrictions. The limited number of local two-way options is the fundamental reason for concern over crossownership. Direct Broadcast Satellite or other video services may eliminate any market power over the provision of video services now held by cable; nevertheless they provide no competition with the telephone company in the local loop.

This section has argued that a complete elimination of the crossownership ban would substantially damage the consumer by reducing competition in an already uncompetitive area. The crossownership ban is only one means of encouraging competition. Alternative policies are discussed below. Although these alternatives are rejected for the present, they may be viable after further development of competitive technology.

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next several years will show whether cable actually does have the potential to offer viable competition to the telephone company. (Naturally this assumes that regulation does not prevent cable systems from competing with telephone companies.)

The options before the Commission are not all equally reversible. If they were, the Commission could afford to experiment with one type of restriction and, if it were unsuccessful, implement another. In fact, it would be far easier for the Commission to reverse itself if it adopted a complete ban on crossownership than if it allowed crossownership and then telephone companies constructed single-wire systems.[55]

D. *Rely on State and Local Governments.*

The earlier chapters of this report argue that many cable concerns are local rather than national. Cable companies serve local markets and are directly subject to local franchise restrictions. The Commission must justify its regulation on the basis of interstate effects. If national concerns cannot be demonstrated, the dangers of crossownership are best left to the local communities or to the states.

Local franchising authorities are affected by many of the dangers involved in telephone provision of cable service. Restricted competition for two-way services is likely to cause local concern. Nevertheless, these local authorities cannot internalize all the costs that are imposed on consumers by crossownership. Concerns facing the nation but not directly affecting local communities include:

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[55] For a discussion of the problems that can develop when a decision must be made that may be reversed in one direction only (i.e., the Commission can reverse its decision to ban crossownership, but would find it difficult to reverse a decision to allow crossownership), see C. J. Cicchetti and A. M. Freeman III "Option Demand and Consumer Surplus: Further Comments," 85 *Quarterly J. of Economics*, 528-539 (1971): The conclusion of this work is that such decisions should only be made when the evidence points strongly in favor of the irreversible choice. If the irreversible choice seems only slightly superior, and if the passage of time will yield information to make a better choice in the future, it should not be adopted.

—The interstate and intrastate toll ratepayers may have to bear a substantial part of the cost of cable facilities (through the separation and settlements process) if the telephone company is able to attribute cable costs to telephone services. Nationwide rate averaging means that states will bear only a small share of any costs that their individual misallocations puts into the interstate rate base.

—The ability of competitive interstate carriers to survive or grow is likely to be damaged by maintenance of local monopoly. Thus crossownership will affect interstate competition.

Therefore, Commission rules that have the effect of limiting local choice are not necessarily arbitrary decisions to overrule local tastes. Rather, they may be taken to ensure that social costs extending beyond a local area are taken into account.

National policy involvement is conditioned on several factors. If all interstate carriers have access to the local market at non-discriminatory rates and terms, and if costs are allocated properly, state regulation can be relied upon. Total reliance on state or local decisions is extreme. Although reliance on state or local franchisers would allow the Commission to focus on other matters, it would do so at high cost. Because cable is a potentially crucial local loop competitor, we do not believe that this alternative should be chosen at this time. As alternative means of access develop, however, the Commission should consider transfering the responsibility of crossownership regulation to the states. States are concerned about local costs and local monopoly abuse. Therefore even after competitive technologies are nationally available, state governments should retain the authority to ban crossownership if the Commission eventually phases out its own rules.

E. *A Regulatory Approach: Partial Separations*

1. *Introduction*

The Commission can also deal with problems of cross-ownership directly, through regulation. One regulatory approach, partial separations, may be a long run means of allowing crossownership even if local competition does not developed fully. For reasons discussed below, however, we do not believe that separations can be relied on at this time. In the following subsections the partial separations idea is developed and the limits it would place on telephone company behavior are decribed. It is argued that rate-of-return or separate subsidiary requirements are of little benefit once separations is adopted. Major drawbacks of the separations policy are detailed in the final subsection.

2. *Definition of Partial Separations in the Cable-Telephone Context*

Partial separations is a system that requires that the use of most of the cable bandwidth be offered on a "common-carrier" basis. This approach deals with monopoly control over local facilities by allowing non-discrimintory access for all who desire to use cable facilities. Under such a policy, a telephone company could not control local distribution over cable even if it owned the cable. Potential competitors would have some form of access to cable facilities despite telephone ownership.[56]

The policy is termed "partial" because the telephone company is allowed to program some share of total cable programming.

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[56] This depends on the effectiveness of the separations policy. Section F argues that implementation of separations policy is premature as it would now be impossible to find a solution that is even close to non-discrimination.

Non-discrimination is the key to an effective separations policy. If the Commission cannot enforce non-discriminatory access, separations policy will fail.[57]

3. *The Share of Programming Allowed Under Separations*

Under this approach, a telephone company should not be allowed to program more than some stated *share* of the total available cable programming. If instead the telephone company were limited to programming no more than some *number* of total channels, it would have an incentive to construct too small a system. On the other hand, if the limit were a share of total *capacity*, the telephone company might allow much of the cable capacity to lie idle.[58] These problems will be averted if the telephone company is allowed to program a well defined share of the total used capacity. Such a requirement would encourage it to lease to competitive programmers in order to program more itself.

For a separations policy to be successful, no single programmer should be able to gain a monopoly position. On the other hand, some programming costs can be reduced by being spread over several channels. For this reason neither a very high, nor a very low share limit (for instance a single channel) would be appropriate. A limit in the range 20 to 30 percent for any one carrier on a telephone company-owned system appears reasonable. This level will allow the company to program a number of channels while leaving a substantial share available to potential competitors. If the telephone company were to gain a dominant position in the cable (say

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[57] A separations policy is regulatory rather than the reverse. A separations policy will involve more regulation than the present ban as a price for eliminating a constraint on telephone company behavior.

[58] It would have these incentives because it could thereby exclude potential users and avoid the purpose of separations policy.

80 percent), it could treat the system as if it were wholly owned from the standpoint of cost-shifting—that is, while it would rather control the entire system, it might be able to engage in join profit maximization and limit competitive entry even though competitors have access to some small share of capacity. If its share were to fall below 5 to 10 percent, it might have little incentive to build a system since it could not take advantage of any special programming advantages that it might have.

The 20-30 percent limit on telephone company programming is not precise. It is unlikely to make much difference whether the highest level is 30 percent or 31 percent. Nevertheless, the higher the level, the greater is the danger from telephone monopoly power. If its allowed share were high, it could leave several potentially profitable video services untapped, and charge monopoly prices for two-way services. Because two-way services require different equipment and may require the potential for a growth in capacity as more customers subscribe, the telephone company could probably encourage potential competitors to use the limited remaining channels for the profitable video alternatives. Setting a lower maximum telephone company share of programming would limit this problem.

4. *Separations Policy and Cost-Shifting*

Separations policy would not eliminate the danger of cost-shifting to avoid telephone rate-of-return regulation, but it might limit it. Separations involves nondiscriminatory charges that are independent of the uses to which cable channels are put.[59] Therefore, fully effective separations policy would eliminate cost-shifting within the cable facility.

In addition, a separations policy can somewhat limit the opportunities for cost-shifting between telephone and

[59] See Chapter 7.

cable facilities. Potential competition with local loop services over cable facilities limits the price that can be charged to telephone users. Thus the need for regulatory control over telephone rates, and the incentives to shift costs would decline.[60] Although the telephone company could increase cable rates to limit this competition, any rate increase would tend to force video programmers as well as two-way cable users off the cable; this would substantially reduce the attractiveness of such a strategy.[61]

5. *The Separate Subsidiary*

In its recent decisions in Computer II and Cellular Radio[62] the Commission relies on a telephone company subsidiary with independent management, capital, and labor to limit cost-shifting. No such separate subsidiary requirement should be applied to a telephone company owned cable system.

We argued in Section I that the most important potential advantages of crossownership come from economies in joint construction and from increased division of labor. Requiring full separation of facilities and eliminating the opportunity for increased specialization of labor would

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[60] The need for regulatory oversight and the danger of cost-shifting depend on monopoly power. If competition develops, such problems are reduced. Separations policy might allow a form of competition. Because of this, dangers of cost-shifting fall.

[61] Because a wide range of alternatives to video services exist, the demands for cable television channel capacity (at the margin where the high demand channels are already being provided) is likely to be quite elastic. Thus any increase in the price of channel capacity would lead to substantial reduction in television type demand and a consequent loss of revenue. That monopoly power is highly constrained by elastic demand is a basic economic principle.

[62] See Computer II Final Decision, 77 FCC 2d, 308, Computer II Reconsideration, 84 FCC 2d, 1; and Cellular Radio, 78 F.C.C. 2d, 984.

make it impossible for a separate subsidiary to achieve these economies. Thus the separate subsidiary requirement eliminates the major advantages of allowing cross-ownership. On the other hand, a telephone company owned separate cable subsidiary that was not subject to a separations policy could constrain two-way service competition by simply not introducing services that an independent system would, or by charging monopoly rates. Such a subsidiary might also be able to shift some costs to the parent telephone company. A separate subsidiary solves none of the problems of telephone ownership, but does eliminate any potential economies.

The only area where a separate subsidiary might serve a useful function is in programming. The expertise and training required for programming are quite different from those required of telephone managers. Little reduction in division of labor would result from a separate programming subsidiary. On the other hand, little would be gained. While the regulator could look to see whether the subsidiary regularly lost money (implying that it was being accorded an unfair advantage against other cable programmers), careful auditing could fulfill the same purpose, and would be equally necessary under a separate subsidiary. Under a separations policy, it would not be worthwhile to extend much favoritism to telephone company owned programmers.

6. *Need Rate Regulation Be Extended to Telephone Company-Owned Cable Systems?*

Telephone companies may be able to evade rate-of-return regulation through ownership of cable facilities. The crossownership ban prevents this but is not the only possible cure. Rate-of-return regulation could be extended to telephone company owned cable systems. This would limit the scope for telephone cost shifting. Alternatively, a cost manual approach could be used to allo-

cate costs without the use of rate-regulation,[63] or rate-of-return regulation could be abandoned altogether.

Many problems of telephone behavior are caused by rate-of-return regulation. Removing rate-of-return regulation from all basic telephone service, however, is beyond the scope of this study. Extending rate of return regulation to cross-owned cable systems (but not to other cable systems) would extend the defects of rate regulation to a new area,[64] [65] although it would reduce, but not eliminate, the danger of cost-shifting. It would do nothing to reduce foreclosure of competition from independent cable.

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[63] This is the approach advocated by Duvall and Pelcovits *supra*, in their examination of private line telecommunications services. It is important to realize that Duvall and Pelcovits discuss a market where costs are already joint or common.

[64] The defects of rate-of-return regulation go far beyond the staffing costs of regulatory agencies. The costs of regulation include those costs, the direct costs imposed on the regulated companies to satisfy the data and legal requirements of the regulatory authority, plus the sometimes substantial costs that society as a whole must endure as entrepreneurs divert their genius into discovering means of evading rate-of-return regulation rather than toward socially productive ends.

It is a commonplace observation that regulation leads to perverse incentives. (See Averch and Johnson, *supra*. See also Cornell, Kelley and Greenhalgh, *supra*.) Historically, rate regulation problems have been compounded by one way risk. That is, if the utility overinvested, the plant becomes part of the rate base; underinventment, reflected in inadequate service, is the cause of strong regulatory reaction. The motives are all toward overbuilding—toward providing a "gold plated" system.

It is these fundamental distortions, not the increase in Commission workload, that causes the gravest concern about any move to spread this form of regulation.

[65] Even if rate-of-return regulation were imposed on both cable and telephone company services, the telephone company may still find some incentive for cross-subsidy between telephone and cable facilities because of differences in elasticities of demand between the sectors, (see Averch and Johnson *supra*.) These incentives, however, are far less powerful than where cable profit can escape regulation altogether.

In recent years, the Commission has regulated interstate telephone services on a service basis after allocating costs among the various services. State regulators do not normally make the same forms of cost allocation. Telephone company ownership and operation of cable facilities would require a careful allocation of costs to protect interstate ratepayers from paying costs generated by a telephone-owned cable facility regardless of whether the cable system is to be rate-of-return regulated.

Because this form of cost separations will be required before rate regulation can be implemented, the potential benefits of rate regulation are small. Regulation can impose high costs on consumers and on taxpayers as well as on the regulated entities. Rate regulation, therefore, should not be extended to telephone company owned cable system.

F. *Problems with the Regulatory Approach*

Several rules are essential to limit the ability of telephone companies to monopolize the local access market. These are: (1) the telephone company must be constrained in the amount of programming that it can offer; (2) access to cable must be made available to others, including potential two-way competitors, on a nondiscriminatory basis; and (3) costs must somehow be allocated between cable facilities and telephone facilities in order to limit cost shifting. None of these requirements will be easy to ensure. Indeed, some of the requirements may be contrary to efficiency.

It will be very difficult to determine whether nondiscriminatory access is actually available. While a one-way wideband channel tariff could presumably be devised in a straightforward way, it is difficult to compare this rate with a one-way narrowband channel rate. It will be even more difficult to compare one-way with two-way rates. Because the telephone company can use its own wire-pair facilities for the provision of two-way services, non-

discrimination between two-way narrowband cable users themselves is insufficient to ensure competition on two-way cable facilities.

If two-way cable technology was already used extensively, and available for comparison, the Commission or local regulators could devise some formula to determine the relationship between two-way and one-way bandwidth rates. Such a formula would have to take into account the cost and demand differentials in each case. At present, however, very few cable systems provide two-way services to large numbers of customers. There is nothing close to a technical industry standard(s), and multiple approachs may be developed.

The Commission cannot easily devise a formula to set relative prices for two-way and one-way bandwidth at the current state of technology. Attempts to do so could preclude some efficient technologies, or could lead to wasteful investment in circumventing regulations rather than meeting them.

Over time, cable systems will begin to implement various two-way technologies. Some are already doing so. Once the technologies are understood, the Commission may be in a position to develop prices that are at least relatively non-discriminatory.

Price discrimination is only one form that discrimination might take. The telephone company could also discriminate against the two-way users by requiring these users to use terminal equipment that meets specifications far in excess of those needed to protect other users.[66] Similarly, the telephone company could offer faster interconnection to one-way users, or could impose technical standards that are difficult for the two-way user to meet. Again, these forms of discrimination would be difficult to detect.

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[66] Such a requirement would violate Part 68 of the Commission's rules. (47 C.F.R. Part 68). Nevertheless, it would be difficult and costly to detect such discrimination.

Even in the long run separations policy is imperfect. Chapter 7 argues that separations policy should not be applied to independent cable systems. Part of the reason is that separations policy prevents efficient cable pricing. This flaw will remain even if the short-run problems with separations in a telephone company owned cable system are managable.

Careful regulation can limit discrimination only if the technology to be used is understood. The costs of this continual regulation, both to the Commission and to franchise authorities, would be high. These regulatory costs and the possibility of limited regulatory effectiveness may make this approach unacceptable even in the long run. Nevertheless, while separations policy must be rejected at this time, we believe that it should be considered as a potentially valuable future Commission policy in dealing with cable-telephone crossownership.

G. *A Continued Ban on Crossownership*

We believe that regulatory tools cannot now solve the problems involved in crossownership between cable and telephone facilities. A continued reliance on the crossownership restriction is necessary. Under the current ban, the cable industry has developed rapidly. Over the past several years rapid growth in cable audiences and programming have been made and new two-way services are being introduced. Cable has expanded rapidly in both urban and rural areas. Moreover, alternative technologies such as direct satellite broadcasting and video-disk/tape players substantially increase the probability that almost every consumer can find supplemental video facilities at some reasonable price. A compelling argument for retaining the current ban, therefore, is that things work quite well under the ban and the potential damage may be great under the alternatives.

Cable is one of the telephone company's very few potential competitors in the provision of local loop access.

No regulatory policy outside of the crossownership prohibition can eliminate the danger of continued telephone control over local loop facilities. On the other hand, further development of competition may reduce the need for any regulatory policy except anti-trust measures. Furthermore, rate regulation gives telephone companies strong incentives to engage in cost-shifting. No regulatory policy outside of crossownership prohibition or the elimination of rate-of-return and entry regulation can completely eliminate this problem.

Telephone companies are allowed to construct cable facilities for lease-back to cable operators. Although a telephone company might be able to use this ability to shift costs or to restrict cable competition, lease-back and waiver standards limit the costs of the ban. The Commission can, and should, be prepared to allow crossownership for experimental and innovative systems. Moreover, the Commission must be prepared to remove the ban if alternative forms of local loop competition become more generally available.[67]

The Commission banned crossownership as the result of several concerns. These concerns have not vanished. Indeed cable now shows greater promise for becoming a competitor in many two-way services than ever before. Therefore the ban should be continued.

H. *General Conclusions*

This Chapter has discussed the rationale for banning crossownership between cable and telephone systems within a service area. A ban has some potentially significant costs, but cooperation between the telephone company and the independent cable franchise holder through

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[67] Likewise, the Commission should continue its policy of allowing crossownership in rural areas where independent cable service is not viable. The benefits of competition are small if no potential entrants exist.

lease-back arrangements can avoid many of these costs. At the moment the current ban is preferable to Commission withdrawal from crossownership regulation.

We conclude that the arguments against crossownership do overcome the presumption that any firm should be allowed to enter cable if it wishes. Telephone companies are an exception. The twin dangers of cost-shifting and foreclosure of competition combine to make unregulated crossownership unacceptable.

If neither complete deregulation nor state or local regulation can be relied upon, the Commission's remaining alternatives are to continue the crossownership ban or to introduce a regulatory approach that allows crossownership but limits abuses through a partial separations policy. We were unable to develop a workable regulatory approach that addresses the real problems. Although we believe that separations policy shows promise as an eventual solution, it cannot be relied upon at this stage. Therefore, we recommend that the crossownership ban be retained.

We conclude that a continued prohibition of telephone ownership of cable remains essential. This need not be a permanent result. The decision depends critically on the nature of competition in the provision of local loop services. Cable facilities are currently one of a very few ways that the telephone company owned local loop can be circumvented. As such, unregulated cable ownership provides an important opportunity for continuing telephone company control over local distribution.[68] The ban may become redundant with the development of XTEN, non-telephone owned cellular radio, direct satellite communications, or other as yet unforeseen technologies. Likewise, if cable remains almost wholly an entertainment medium, the ban will serve little useful purpose and should be eliminated.

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[68] See "Comments of Department of Justice in CC Docket 80-767" (Rural Cable-Telco Cross-Ownership) (1981).

If the Commission retains the existing crossownership ban, it should reiterate and amplify its waiver standards. Telephone companies that propose technically innovative systems should be granted limited experimental waivers, even if they cannot demonstrate the current strong cost economies specified in the Commission's Sugar Land decision. The Commission should not stand in the way of innovation. Such a waiver process, and an expanded role for lease-back arrangements, can go a long way toward achieving the most important advantages of crossownership.

It is possible that some states can develop regulatory approaches that will satisfy themselves and the Commission. If a State wishes to implement a separations approach, the Commission should consider allowing it to do so. Because of substantial interstate concerns, the Commission cannot automatically accept any proposal. It could consider allowing some flexibility, especially after several years, when the competitive technologies being developed by the cable industry are better understood.

The basic conclusions developed in this chapter are three.

- The Commission should retain the current crossownership ban.
- The Commission should allow lease-back agreements and rely more fully on the protection of independent cable operators offered by the Pole Connection Act.
- The Commission should entertain experimental telephone waivers that propose innovative cable technologies.

The information gained in these experiments on the development of cable technology and on alternative forms of local competition, will be helpful in a future reevaluation of the crossownership ban.

GAO

United States General Accounting Office

Report to Congressional Requesters

October 1987

TELEPHONE COMMUNICATIONS

Controlling Cross-Subsidy Between Regulated and Competitive Services

[GAO Logo]

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-229035

October 23, 1987

The Honorable Edward J. Markey
Chairman, Subcommittee on
Telecommunications and Finance
Committee on Energy and Commerce
House of Representatives

The Honorable Mike Synar
House of Representatives

The Honorable Timothy E. Wirth
United States Senate

In response to your requests, this report evaluates the use of accounting controls to prevent cross-subsidization between regulated and nonregulated telephone service and addresses the resources, motivation, and authority of the Federal Communications Commission to police the behavior of the telephone companies if and when they enter new competitive businesses.

As arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to the Chairman, Federal Communications Commission; interested congressional committees and subcommittees; and individual mem-

bers of the Congress, as well as other interested parties. Copies will be made available to others upon request.

A list of major contributors to this report is included in appendix III.

/s/ J. Dexter Peach
J. DEXTER PEACH
Assistant Comptroller General

EXECUTIVE SUMMARY

Purpose

Advances in technology, as well as industry deregulation and restructuring, have resulted in telephone companies seeking to offer competitive telecommunications services in conjunction with their regulated services. The Congress and telephone industry regulators are currently faced with deciding how best to bring new services to the public. Both telephone companies and users can potentially benefit from new competitive services. However, without adequate safeguards and regulatory oversight to ensure that costs are properly allocated, local telephone customers risk subsidizing the competitive services (cross-subsidy) through their telephone bills.

The Federal Communications Commission (FCC) decided in 1986 to permit greater integration of competitive and regulated operations as long as prescribed cost allocation standards and procedures are followed. Congressional requesters asked GAO for information on the background and rationale for FCC's actions, as well as FCC's ability to implement the cost allocation procedures to control cross-subsidy between companies' regulated operations and their competitive ventures, which are nonregulated.

Background

In a series of decisions since 1971, FCC has dealt with the increasing convergence of computer and telecommunications technology by delineating "basic" regulated services and "enhanced" nonregulated services, and setting the conditions under which telephone companies could offer enhanced services using the regulated telephone network. FCC has generally required telephone companies to offer such services through a structurally separate subsidiary, to protect telephone customers from helping to

pay the costs of competitive activities and protect competitors from unfair competition.

In 1986, however, FCC determined that separate subsidiaries were both inefficient and restricted the advance of technology. It adopted a new program of nonstructural safeguards to promote technology and efficient network use, while still addressing ratepayer and competitive concerns. A key nonstructural safeguard that FCC adopted is a process for allocating telephone company costs shared by both regulated and nonregulated operations. Elements of this process include (1) cost allocation standards and accounting procedures, (2) company cost allocation manuals, and (3) annual certified public accountant (CPA) reports attesting that the allocations accurately reflect procedures in the cost manuals. FCC will oversee the entire process and use its own auditors to periodically examine the cost allocations.

Overlying the FCC's efforts to accommodate the integration of regulated and competitive services is the U.S. district court's review of line-of-business restrictions on the seven regional Bell Operating Companies set by the 1984 Consent Decree breaking up the American Telephone and Telegraph Company. The court's September 1987 decision partially relaxed some of the restrictions, meaning some additional integration of regulated and competitive services is likely, although not as much as FCC, the Bell Operating Companies, and others had wanted.

Results in Brief

FCC's actions in prescribing cost allocation standards and requiring cost manuals and annual independent audits are all essential steps of an oversight program to ensure that telephone rates are not subsidizing competitive ventures. FCC expects these measures to provide assurance

to the public that its rules and procedures are being followed consistently and that cost allocations are documented and accurately presented.

However, the unavoidably subjective nature of the cost allocation process and FCC's "public interest" mandate require that it remain involved in overseeing the allocation process and ultimately deciding whether the companies' results are acceptable. FCC plans to audit company records periodically, but at existing staffing levels these audits will be infrequent.

The level of oversight FCC is prepared to provide will not, in GAO's opinion, provide telephone ratepayers or competitors positive assurance that FCC cost allocation rules and procedures are properly controlling cross-subsidy.

Principal Findings

Past Allocation Difficulties

FCC's past cost allocation efforts have been difficult and time-consuming. Reasons for these difficulties include the lack of systematic cost allocation standards and procedures, and the inherent subjectivity, and thus arbitrary nature of the cost allocation process as applied to telephone services sharing common equipment. Economics and accounting both provide guidance on allocating costs, but do not prescribe one single "right" way. Consequently, disagreement is understandable among the affected industry and consumer interests, making it difficult for FCC to arrive at a consensus. In the past FCC justified its requirements for separate subsidiaries by citing the "inherent difficulties" in allocating costs.

FCC's New Regulatory Approach

FCC eliminated the separate subsidiary requirement because it impeded companies from offering new services and therefore imposed costs on the public. FCC deter-

mined that these costs exceeded the benefits that separation had provided by preventing cross-subsidy and other competitive abuses. Still, FCC recognized that some regulatory controls were needed to prevent telephone companies from subsidizing their nonregulated services with regulated revenues or using their control over regulated services to discriminate against competitors.

FCC's new cost allocation program attempts to overcome past problems by developing objective criteria—allocation procedures and cost manuals—to assess compliance. In addition, as a principal oversight tool, FCC is relying heavily on annual reports by CPAs attesting that a company's implementation of cost allocation follows FCC's rules. These reports should help ensure particularly that documentation is adequate and procedures are consistently applied. However, the difficulty in allocating costs of services sharing common facilities and personnel, particularly switching equipment, along with FCC's mandate to determine that regulated telephone rates are "just and reasonable," require ultimately that FCC exercise its own judgment that the telephone company costs are properly allocated.

Limited FCC Oversight

To make these judgments, FCC's periodic audits of telephone companies are crucial, particularly over the next few years, when gaining public acceptance is important. Other means of oversight—including a new computerized data base and access to the CPA's workpapers—are also important as indicators of potential problems that may require FCC to examine company records. FCC will have access to company books and records, and plans to conduct its own audits, but at its existing level of staff and travel resources, these audits will be infrequent. Further, its fiscal year 1988 budget request proposed eliminating 3 of its 15 auditors.

Recommendation

GAO recommends that FCC develop a strategy for providing greater oversight of telephone companies' cost allocations. The key to the strategy is FCC's commitment to allocate sufficient audit staffing and travel funds to permit added field audits.

Agency Comments

As directed by the requesters, GAO did not obtain official comments on a draft of this report. However, GAO discussed the factual information in the report with FCC officials during the course of the work and incorporated their views as appropriate. FCC officials noted that, for the past 2 years, they had requested additional auditors, but that the requests had not survived the budget review process after submission to the Office of Management and Budget.

* * * * *

Chapter 4

FCC's Cost Allocation Rules Will Provide Only Limited Assurance That Cross-Subsidy Is Being Controlled

FCC is in the midst of implementing its new cost allocation rules and procedures—using accounting controls instead of separate subsidiaries—thus, it is impossible to forecast exactly how well these new controls will work. As discussed earlier, there is great concern about the growing potential for carriers to subsidize their competitive activities in the future. Based on our assessment of FCC's progress and plans to date, however, we believe FCC will not be able to provide positive assurance that carrier costs are being properly allocated and cross-subsidy is being controlled. Since FCC's new regulatory program requires more oversight than the structural separation approach, it is essential for public acceptance of the program that FCC be able to provide a high degree of assurance to ratepayers and carrier competitors that cross-subsidies are being properly controlled.

FCC has stated in its joint cost decision that it is critical to oversee how the carriers implement the rules and procedures. We concur that oversight is important, especially in the first few years when it is essential that the carriers implement the new procedures properly, with the benefit of timely feedback from FCC. In addition, because FCC in recent years has actively promoted deregulation in the telecommunications industry, it is essential for FCC to provide assurances to the public that it is serious about fulfilling its regulatory oversight responsibilities. Whether a continued program of intense oversight is necessary in later years may depend on proper guidance and direction initially.

The CPA attestation reports will go a long way toward assuring FCC the new procedures are properly implemented, in particular concerning such aspects as ade-

quacy of carrier documentation and consistency of application from year to year. However, the unavoidably subjective elements contained in (1) the cost allocation process, (2) the CPA attestation, and (3) FCC's mandate to determine that rates are "just and reasonable," require ultimately that FCC exercise its own judgment that the carriers' costs are properly allocated.

FCC's access to carriers' books and records is its main oversight mechanism in making these judgments. Its other means of oversight—tariff review, the ARMIS system, the complaints process, and review of CPA attestation reports—are also important, but these are essentially indicators of potential problems that may lead FCC to audit carriers and ultimately decide if costs are properly allocated.

The basis on which FCC will routinely determine that cost allocations are properly preventing cross-subsidies is questionable. The absence of complaints or other indicators of problems may cause FCC to conclude that no problems exist, but as we discussed in chapter 3, these indicators may not be effective, at least initially. While FCC will certainly investigate major problems if they are brought to its attention, it is also important for FCC to routinely sample carrier books and records to assess compliance and also judge the CPAs' work. We see FCC at present with only the ability to do infrequent reviews of carrier records, given available audit staff and travel funds. Further, FCC's fiscal year 1988 budget request proposed to eliminate three auditor positions.

Judgment Is an Inherent Element of FCC's Cost Allocation Rules

Part of FCC's past problem with cost allocations, as we discussed in chapter 2, has been the inherent subjectivity of the cost allocation process. FCC's new joint cost rules

are an attempt to deal with the problem by specifying procedures and requiring carriers to have cost manuals. Together, these serve as objective means against which FCC and the CPAs can judge compliance. Still, subjective elements will continue to play a major role in the entire process, given the difficulty in objectively allocating the costs of telephone services sharing common equipment, coupled with the judgmental aspects of both the CPA attestation audit and FCC's obligation to see that rates are "just and reasonable."

The public accounting firm, Coopers & Lybrand, in commenting on FCC's joint cost rules, recognized the value of the independent attestation, but concluded that FCC still has the major responsibility for evaluating the entire process. Coopers & Lybrand stated that

> "The use of independent audits will provide the federal regulator with verification that the numerical calculations are accurate and data sources are reasonable, and both reflect the approved cost manual procedures. This type of audit is quite far-reaching and informative as to compliance with cost allocation procedures employed by an individual carrier. However, in such audits, the adequacy of the cost allocation plan is assumed. The independent audit process is not intended to serve as a means to draw parallels or to make qualitative or quantitative judgments on another company's cost allocation manual process. As the [joint cost] Order states, the FCC retains the major burden on determining initial compliance and on the evaluation and monitoring of the process as a whole." [1]

Written comments provided by two other public accounting firms in FCC's joint cost proceeding both recognized

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[1] *Assessment of Current Status of FCC Cost Accounting Intiatives: CC Docket 86-111*, prepared by Coopers & Lybrand for United States Telecommunications Suppliers Assn., Mar. 1987, p. 17.

the subjective elements involved in making cost allocations. One firm, Price Waterhouse, helped prepare a draft cost allocation manual for Southwestern Bell Telephone Company that was over 100 pages long and contained specific detailed instructions on how to allocate each of Southwestern Bell's various expenses. Despite the detail, however, the manual recognized the subjective nature of cost allocations. For example, the manual states that ". . . no generally acceptable allocation technique has been identified as appropriate in all circumstances." The manual also discussed allocating general overhead expenses (such as officer salaries) on an "intuitively logical manner." [2] Similarly, comments prepared by the accounting firm, Peat, Marwick, Mitchell & Co., setting forth its view on cost accounting methodologies, stated that "There will always be tradeoffs in the selection of an approach, namely precision, reliability, and level of information against the cost of implementation." [3] In this regard, a paper prepared by an economics consulting firm discussing FCC's proposed joint cost rules stated that allocation problems are

> ". . . caused not by accounting abuses but by the arbitrariness of allocations used to divide joint costs, the discretion that must be given to the firm to decide which of several allocators to use, and the ability of the regulated firm to choose resources and technologies that evade the constraints of the costing process." [4]

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[2] Cost allocation manual prepared by Price Waterhouse, submitted with comments of Southwestern Bell Corp. on Docket 86-111, June 1986, section 2, p. 10.

[3] "Evaluation of Cost Allocation Manuals," prepared by Peat, Marwick, Mitchell & Co., submitted with reply comments of American Telephone and Telegraph Co., on Docket 86-111, July 1986, p. I-8.

[4] *Accounting Separations: A Contradiction in Terms*, by Cornell, Pelcovits & Brenner Economists Inc., Mar. 1986, p. 23.

The attest examination itself will also require the exercise of judgment on the part of the CPA. The American Institute of Certified Public Accountants' *Statement on Standards for Attestation Engagements* is to be followed by CPAs doing attest work. This statement recognizes the role that judgment can play in reaching a conclusion. It says,

> "Competent persons using the same or similar measurement and disclosure criteria ordinarily should be able to obtain materially similar estimates or measurements. However, competent persons will not always reach the same conclusion because (a) such estimates and measurements often require the exercise of considerable professional judgment and (b) a slightly different evaluation of the facts could yield a significant difference in the presentation of a particular assertion." [5]

The statement also says the CPA should consider "materiality" when reporting his conclusion. A CPA's judgment of what is material may well differ from that of an FCC regulatory auditor.

The ultimate exercise of judgment occurs when FCC carries outs its "public interest" responsibility and determines that rates are "just and reasonable." This concept appears to be similar to the concept of "fairness" that was mentioned in chapter 3 as being a fundamental criterion in any allocation process. FCC defined "just and reasonable" in the joint cost order as both (1) protecting ratepayers by assuring rates do not subsidize nonregulated services and (2) promoting savings to the ratepayer from the integration of regulated and nonregulated services.

For example, based on its "public interest" responsibilities FCC could require a carrier to adjust its cost allocations

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[5] *Statement on Standards for Attestation Engagements*, American Institute of Certified Public Accountants, Mar. 1986, p. 10.

if, in its judgment, the result would be more nonregulated services being offered. In justifying its Computer III decision, FCC cited such a service, called Custom Calling II, that no carrier had offered while structural separation requirements were in effect.

Assurance Is the Key to Acceptance of FCC's New Regulatory Program

It is essential that FCC create public confidence in its new regulatory program to ensure both telephone ratepayers and firms competing with carriers that a carrier's regulated services do not subsidize its nonregulated activities. Assurance is particularly important over the next few years to counter the uncertainty and anxiety that will exist over (1) how both the carriers and competitors will behave under a new set of regulatory ground rules and (2) how effectively FCC will oversee the program. As time goes by, the need for assurance may lessen as everyone's comfort level with the program increases.

The Department of Justice consultant's report, *The Geodesic Network*, discussed both the potential and likelihood of cross-subsidy occurring if carriers entered a number of nonregulated telecommunications markets. The report generally found moderate to high percentages of costs potentially shiftable from nonregulated to regulated operations. However, the report generally did not see any cross-subsidy having much of an immediate impact on regulated rates because of the small size of the nonregulated activities compared with regulated operations.

Cross-subsidy is not a large problem at present but the potential is great. Where a firm operates in two markets —one is monopolizes and another with many competitors —it has an incentive to subsidize the competitive mar-

kets by undercharging for competitive services and/or shifting costs to the captive monopoly market. Cross-subsidy has not been a large problem to this point because carriers' relatively small investments in competitive markets dilute any impact on telephone rates. The potential will become greater in the future for a number of reasons. First, carriers are increasingly investing in competitive ventures. Second, the recent decision by the divestiture court relaxed some restrictions on BOCs' investment in competitive areas. Although the BOCs did not get all the relief they wanted, the court opened new areas e.g., the ability to provide information service transmission. Third, FCC's Computer III regulatory scheme allows monopoly and competitive operations on an integrated basis making cross-subsidy more difficult to detect.

The Justice consultant's report presented a hypothetical example of the potential cross-subsidy due to cost shifting by a carrier offering nonregulated electronic mail service.[6] Two-thirds of the costs of an electronic mail operation could be potentially shiftable to similar cost categories in regulated operations, the report said. The example showed that $200 million, or 11 percent, of a carrier's regulated costs fall into categories potentially shared with an electronic mail operation. If there was a 10-percent increase in these $200 million of regulated costs due to cross-subsidy, there would be only a 1-percent increase in total carrier regulated costs, a small impact on regulated rates. However, this same 10-percent increase on the regulated side due to cost shifting would yield a corresponding decrease of 7 percent in nonregu-

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[6] Electronic mail service is defined as a computer-based method of transmitting information that involves composing messages on a computer terminal, transmitting them electronically, and storing them in computer storage for later retrieval by a recipient.

lated costs, a significant impact on competitive operations.[7]

FCC's requirement that each CPA attestation report provide a "positive" level of assurance rather than a "negative" level of assurance will provide FCC a greater degree of assurance. However, FCC's own oversight of the cost allocation program will provide only a "negative" assurance that cross-subsidy is not occurring because of the limited FCC staff available to examine carrier books and records.

Limited FCC Staffing Will Reduce the Level of Assurance

Adequate FCC resources for overseeing and enforcing cost allocation rules has been a concern both in past FCC actions related to Computer II and also in connection with Computer III and the joint cost rules. In the Computer II decision and related proceedings, FCC indicated that among the reasons structural separation was preferable to accounting controls alone was that such controls were more difficult to implement, and could require added staff and more intrusion in monitoring efforts. Similar concerns over FCC's oversight capability were raised in June 1986 by several commenters in the joint cost proceeding. In particular, the Department of Justice recognized the benefits of requiring annual CPA audits but still called for a "vigorous" FCC audit program focusing on both problem areas and randomly selected companies. Justice comments expressed concern

> ". . . that at present the Commission does not have a sufficient number of auditors to take on the increased responsibilities resulting from this proceed-

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[7] *The Geodesic Network, 1987 Report on Competition in the Telephone Industry*, Consultant's Report to the U.S. Department of Justice, Jan. 1987, pp. 11.16-11.18.

> ing. The failure to devote sufficient resources to the audit process will reduce any prophylactic program, no matter how sound in theory or principle, to a sham that deceives rather than protects ratepayers and state regulators. Thus, we cannot stress too strongly the importance of the commission allocating adequate resources to enforce the accounting rules before separate subsidiary requirements are eliminated." [8]

The North American Telecommunications Association said that if FCC is to fulfill its auditing objectives, it must immediately seek staff reassignment within FCC and pursue additional funding for the auditing functions.[9] In rebuttal, FCC said that it was committed to fulfilling this oversight responsibility, but did not provide any specifics on its plans to audit carriers. FCC's Common Carrier Bureau staff informed us that they are optimistic about preventing cross-subsidy and cited the elements of its program to oversee the cost allocations, i.e., CPA attestation reports, the ARMIS system, and FCC audits.

Requests for Increased Audit Staff Denied

Since fiscal year 1983, overall staffing of the Accounting and Audits Division has more than doubled, with Audits Branch staff increasing by eight auditors in the post-divestiture year of 1985. For fiscal year 1987, the Division has approximately 67 persons, including 22 in the Audits Branch. Of the 22 staff members, the branch has 15 persons listed as auditors, while the remainder are in management, legal, and support categories. FCC has requested additional auditors in its recent budget pro-

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[8] Comments of the U.S. Department of Justice on Docket 86-111, June 1986, p. 36.

[9] Comments of the North American Telecommunications Assn., on Docket 86-111, June 1986, pp. 38 and 39.

posals to the Office of Management and Budget (OMB), but increases have not been approved. In fact, FCC's fiscal year 1988 congressional budget submission called for a decrease of three auditors.

For fiscal years 1987 and 1988, FCC's proposals to OMB were for an added nine and three auditors, respectively. However, the FCC congressional budget submissions asked for no additional auditors in 1987 and the reduction of three positions in 1988. The justifications for the increases were similar: The Commission is increasingly relying on auditing to protect ratepayers from bearing costs that are not associated with regulated services and to ensure fairness in the marketplace. Other factors contribtuing to an increase in audit requirements included an increase in the number of regulated carriers as a result of the AT&T divestiture, the increased movement of such regulated companies into unregulated businesses, revisions of the manual used in separating costs between interstate and intrastate services, the monitoring of Computer II and III compliance, the implementation of the revised Uniform System of Accounts, and, of course, the implementation of the carriers' cost allocation manuals under the joint cost decision's standards.

To justify its proposal for the additional auditors for 1988, FCC's Common Carrier Bureau said that it had identified 256 areas [10] in the operations of the major carriers that it had responsibility for auditing on a routine basis. The Bureau acknowledged, however, that resources were unavailable to perform these audits annually. Instead, according to the Bureau, a more reasonable plan would be to spread out the audits in order to control costs

[10] FCC identified the 256 areas requiring audit attention in the 20 operating companies owned by the regional BOCs, the 7 regional BOCs themselves, and 2 other major independent telephone companies—GTE and United Telecom. The regulatory areas included were USOA, separations process, access charges, joint costs, Computer III, and depreciation rates.

while still giving the Commission some assurance that carriers are complying with rules. Its proposal was to conduct about 32 audits a year, meaning FCC would audit each of the 256 areas once every 8 years. FCC also calculated that on the average this level of effort would allow it an audit presence at most of the major carriers once every other year.

Because FCC's requests for more auditors in each of its past two budget proposals have not survived OMB review, they have not been included in the congressional budget submissions. Reasons cited were to cut budget and alternatives to in-house auditing, i.e., the independent CPA reports.

While FCC had requested increased staff to allow it to conduct 32 audits a year, we noted in chapter 3 that in recent years it had conducted between 9 and 18 audits annually. If an annual level of 16 audits per year with present staff is assumed, FCC would examine each of its audit areas at the major carriers or holding companies only once every 16 years. With the further staffing reduction requested for fiscal 1988, the interval between audits increases even further. While FCC has the discretion to prioritize its audit areas and thus to audit the joint cost allocations more frequently than every 16 years, to do so would short-change its other audit responsibilities, such as the USOA financial reports, separations process, depreciation rates, and access charges.

It is conceivable that FCC auditors, being able to rely on the work conducted by CPAs, may be able to conduct their own audits more quickly and thus increase their productivity even with fewer auditors. However, this is not likely at current budget levels, since FCC staff said that a major constraint on their audit capability is travel funds with which to visit the carriers' offices. Bureau officials reported that only $34,000 had been allotted for audit travel in fiscal 1986 and $32,000 will have been

spent on audit staff travel in fiscal 1987. FCC had unsuccessfully proposed a $184,000 increase to OMB for 1987 for the existing and proposed staff. FCC's fiscal 1988 congressional budget submisison, which is still pending, would result in an increase of $35,000 for Common Carrier Bureau travel. If approved, FCC officials said that the Audits Branch will receive some of this increase.

Statements by FCC officials regarding staffing have been inconsistent. In February 1987, then FCC Chairman Fowler defended the proposed FCC cut of three auditors before the Senate Appropriations Committee. He said that

> "As the regulated telephone companies provide us with independent detailed audits of their operations, we believe we can eliminate one of the audit teams we presently have without adversely affecting our regulatory responsibilities." [11]

Previously, at the December 1986 meeting when the Commisison adopted the joint cost rules, Commissioner Mimi Dawson told her fellow commissioners that this effort is "an area where we desperately need resources. Without this, the strides we've made won't be able to move forward."

Conclusions

The actions FCC has taken in prescribing cost allocation standards, requiring FCC-approved cost manuals, and requiring annual CPA attestation reports are essential steps in implementing a program of accounting controls to guard against cross-subsidy. FCC expects these measures to help overcome problems encountered in its past cost allocation activities, which we discussed in chapter 2. Together, FCC expects these measures to go far towards

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[11] Testimony of Mark S. Fowler before the Subcommittee on Commerce, Justice, State, the Judiciary, and Related Agencies, Senate Committee on Appropriations, Feb. 1987.

providing assurance that its rules and procedures are being followed consistently and that the carriers' cost allocations are adequately documented and accurately prepared. However, FCC still has a major role to play in overseeing the allocation process and ultimately accepting the carriers' results, given the subjective nature of the process and FCC's "public interest" mandate.

FCC is embarking on a new regulatory program designed to be less restrictive on carriers' activities but that paradoxically may require a greater degree of FCC oversight. FCC has said that it is committed to fulfilling its oversight responsibility, but also has proposed in its congressional budget submission to reduce its audit staff. We share Justice's concern over the need for adequate resources to ensure the integrity of the entire program.

FCC plans to audit carrier records periodically, but at existing staffing and auditing levels these audits will be infrequent, conceivably once every 16 years. At this staffing level, FCC's substantive role may be limited to responding to complaints or problems brought to its attention, but as we noted in chapter 3, the complaints process FCC has relied on to oversee carriers in the past may not work well due to restrictions on public availability of data on carriers' nonregulated activities.

Overall, the level of oversight we see FCC prepared to provide will not, in our opinion, ultimately provide telephone ratepayers or carrier competitors positive assurance that FCC's joint cost rules will guard against cross-subsidy. Such assurance is important in the future with the growth in carriers' competitive ventures, the loosening of restrictions on their entry into more of these ventures, and the increased potential for undetected cross-subsidy in the absence of structural separation requirements.

FCC needs to match its stated intent with plans and resource commitments to assure that it can perform its

oversight role in a timely and thorough fashion. It would be a small consolation for a business that tried unsuccessfully to compete with a regulated carrier to learn from FCC years later that costs had been misallocated, thus hurting its ability to compete. The telephone ratepayers need more immediate assurance as well that allocations are being done fairly.

We cannot say exactly how often FCC should audit or whether the absence of audits will result in undetected cross-subsidy. Certainly the absence of audits increases the risk that cross-subsidy will occur. As we noted in chapter 3, past FCC audits have not resulted in findings of major cost misallocations, so additional resources cannot automatically be expected to result in savings to the ratepayer. However, as we have pointed out, the potential for cross-subsidy is great given the competitive and regulatory environment. An aggressive program of carrier audits by FCC, building on the annual CPA attestation reports, will help create public confidence in the program and send a message to carriers that they can expect FCC to be closely monitoring their activities, at least initially, to make sure they get started properly.

Recommendation to the Chairman,
Federal Communications Commission

We recommend that FCC develop a strategy for providing greater levels of oversight and assurance that carriers are properly implementing its cost allocation procedures. The key to the immediate success of such a strategy or plan is FCC's commitment to allocate sufficient audit staff and travel funds, obtained either by reallocation of current FCC resources or through additional funding.

Elements of a successful strategy should include plans for periodically examining both carrier records and the workpapers supporting the CPA attestation reports. In addition, a strategy should incorporate the flexibility to investi-

gate problem areas identified through the ARMIS system, tariff review, and other means, as well as auditing carriers selected at random. FCC will have to set priorities, since it will likely face continued resource constraints. However, with the ARMIS system and greater audit coverage provided by the CPAS, FCC may ultimately be able to develop alternative review and audit techniques less resource-intensive than its traditional full-scale audits. Also, less frequent audits may be needed once the carriers have become used to the cost allocation procedures and FCC has completed an audit cycle.

LICENSE AGREEMENT FOR POLE ATTACHMENTS AND/OR CONDUIT OCCUPANCY IN THE COUNTIES OF DICKENSON, WISE AND LEE AND IN THE CITIES AND TOWN GEOGRAPHICALLY LOCATED THEREIN.

DATED September 1, 1992

BETWEEN

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA
(LICENSOR)

AND

CENTURY MOUNTAIN CORPORATION
(LICENSEE)

ARTICLE VIII

MAKE-READY WORK

A) Poles, Anchors, Guys

1) When an application for attachment to a pole, anchor or utilization of an anchor/guy strand is submitted by Licensee, a prelicense survey will be required to determine the existing adequacy of the pole, anchor, and/or guy to accommodate Licensee's communications facilities. Utilization of the existing available capacity of an anchor/guy strand, when such utilization does not result in a reduction of the holding capacity below the level normally required by the Licensor for safety or other purposes will be permitted at the option of the Licensor and upon agreement by the Licensee to payment of the charges as specified in APPENDIX I.

2) The field inspection portion of the prelicense survey, which requires the visual inspection of existing poles, anchors and guy strands, may be performed by the Licensor or Licensee (with optional participation by joint user and/or Licensee). The administrative processing portion of the prelicense survey, which includes the processing of the application, the preparation of the make-ready work orders, the coordination of work requirements and schedules with joint users and other attachees and the random field verification of field inspection results data developed and furnished to the Licensor by the Licensee will be performed by the Licensor.

(a) When the Licensor performs any portion of the prelicense survey, the Licensor will ad-

vise in writing of the estimated charges that will apply and receive written authorization from the Licensee before undertaking any portion of the prelicense survey (Appendix III, Form B-1).

(b) When the Licensee performs the field inspection portion of the prelicense survey the field inspection results data will be furnished to the Licensor in a format specified by the Licensor and according to standards of accuracy and completeness satisfactory to the Licensor. In view of Licensor's common carrier obligations to maintain safe adequate service, Licensor retains the right to redo the field inspection portion of the prelicense survey if in the sole judgment of the Licensor the data furnished by the Licensee does not comply with the performance standards as prescribed by the Licensor. The Licensee shall pay the Licensor for the total expense incurred by the Licensor to redo the field inspection.

3) Licensor reserves the right to refuse to grant a license for attachment to a pole or anchor, or utilization of an anchor/guy strand when Licensor determines that the available capacity on such pole, anchor and/or guy strand is required for its exclusive use or that of a joint user or governmental entity with pole attachment rights and that the pole, anchor, or guy strand may not reasonably be rearranged or replaced to accommodate Licensee's communication facilities.

4) In the event Licensor determines that a pole and/or anchor to which Licensee desires to attach or an anchor/guy strand which Licensee desires to utilize is inadequate or otherwise needs rearrangement of the existing facilities thereon to accom-

modate the Licensee's communications facilities, Licensor will advise the Licensee in writing of the estimated make-ready charges that will apply (Form B-1).

Licensee shall have 90 days from the receipt of Form B-1 to indicate its written authorization for completion of the required make-ready work and acceptance of the resulting charges. However, if Licensor receives a request from an additional licensee for attachment to a pole or anchor, or utilization of an anchor/guy strand for which a Form B-1 has been sent to an initial licensee, the initial licensee must authorize completion of the pending make-ready work and resulting charges within 15 days after the receipt of written notification from Licensor of the additional attachment request or until the end of the aforementioned 90 days notification period, whichever period of time is shorter.

5) Make-ready work will be performed by the Licensor following receipt of the required written authorization and advance payment from the Licensee. Licensee shall pay the Licensor for all make-ready work completed in accordance with the provisions of this Agreement and Licensee shall make arrangements with the owners of other facilities attached to such poles and/or anchors regarding reimbursement for any expense incurred by them in transferring or rearranging their facilities to make such attachment accommodations available. Licensee shall not be entitled to any monies paid to the Licensor for pole, anchor or guy strand replacements or for rearrangement of facilities on a pole or anchor by reason of the use by the Licensor, joint user, governmental entity or other authorized licensees of

any additional capacity resulting from such replacement or rearrangement.

6) Should Licensor, joint user or governmental entity having pole, anchor or anchor/guy strand accommodation rights, for its own service requirements, need to attach additional facilities to any number of poles or anchors to which Licensee is attached or avail itself of the holding capacity of an anchor/guy strand being utilized by the Licensee, Licensee will either rearrange its facilities on the pole or anchor or transfer them to a replacement pole or anchor, as determined by Licensor so that the additional facilities of Licensor, joint user or governmental entity may be accommodated. The cost of such rearrangement and/or transfer will be at the sole expense of the Licensee. If Licensee does not rearrange or transfer its communications facilities within 60 days after receipt of written notice from Licensor requesting such rearrangement or transfer. Licensor or joint user may perform or have performed such rearrangement or transfer without liability on the part of Licensor or joint user and Licensee shall be liable for the full costs thereof.

7) License applications received by Licensor from two or more licensees for attachment to the same pole, anchor, or utilization of the same anchor/guy strand will be processed by Licensor in accordance with the procedures detailed in APPENDIX II.

8) Whenever it is necessary for Licensor to replace its pole to accommodate Licensee's communications facilities, Licensor will grant Licensee the option where possible, and where possible and acceptable to joint user, to become the owner of

the pole and its associated guys and/or anchors, upon payment of all replacement costs on a fully installed basis. This option is subject to the further conditions that:

(a) Licensee grants Licensor and any existing joint user or authorized attachee the right to attach their respective facilities to such replacement pole and/or associated anchor upon the same terms and conditions as set forth in this Agreement, and,

(b) that any governmental entity having attachment rights to said pole and associated anchor shall be granted similar attachment rights under the same terms and conditions as apply to the pole being replaced.

Should Licensee exercise this option and become the owner of the pole and associated guy strands and/or anchors, it agrees to maintain the pole and associated guy strands and/or anchors in a safe and serviceable condition for attachment of Licensor and joint user facilities for as long as licensee owns an interest in the pole.

B) Conduit System

1) When an application for conduit occupancy is submitted by the Licensee a prelicense survey by the Licensor will be required to determine the availability of the conduit system to accommodate Licensee's communications facilities. Licensor will advise the Licensee in writing of the estimated charges that will apply for such prelicense survey and receive written authorization from the Licensee before undertaking such a survey (Form B-1). A representative of the Licensee may ac-

company the Licensor's representative on the field inspection portion of such prelicense survey.

2) The Licensor retains the right, in its sole judgment, to determine the availability of space in a conduit system. In the event of the Licensor determines that rearrangement of the existing facilities in the conduct system is required before Licensor's conduct system need, for its own service requirements, any of the conduit capacity in writing of the estimated make-ready charges that will apply for such rearrangement work (Form B-1).

   Licensee shall have 90 days from the receipt of Form B-1 to indicate its authorization for completion of the required make-ready work and acceptance of the resulting charges.

3) Should Licensor or any governmental entity with whom Licensor has ~~an~~ agreement granting such entity priority access to and/or occupancy of Licensor's conduct system need, for its own service requirements, any of the conduit capacity occupied by Licensee's communications facilities, and Licensee's communication facilities can be accommodated otherwise in Licensor's conduit system, Licensee shall be required to rearrange its communications facilities in the manner designated by the Licensor and at the expense of Licensee. If Licensee has not so rearranged its communications facilities within 60 days of receipt of written notice from Licensor, Licensor may perform or have performed such rearrangement without any liability on the part of the Licensor and Licensee shall be liable for the full costs thereof.

C) In performing all make-ready work to accommodate Licensee's communications facilities, Licensor will

endeavor to include such work in its normal work load schedule.

ARTICLE IX

CONSTRUCTION, MAINTENANCE AND REMOVAL OF COMMUNICATIONS FACILITIES

A) Licensee shall, at its own expense, construct and maintain its communications facilities on poles and/or anchors, and in conduit systems covered by this Agreement in a safe condition and in a manner acceptable to Licensor, so as not to physically conflict or electrically interfere with the facilities attached thereon or placed therein by the Licensor, joint users, or other authorized licensees.

B) Licensor shall specify the point of attachment on each pole or anchor to be occupied by Licensee's communications facilities. Where communications facilities of more than one licensee are involved. Licensor will attempt to the extent practical, to designate the same relative position on each pole or anchor for each licensee's communications facilities.

C) Licensee shall notify the Licensor in writing at least 30 days before adding to, relocating, replacing or otherwise modifying its facilities attached to a pole and/or anchor where additional space or holding capacity may be required on either a temporary or permanent basis.

D) The Licensee must obtain prior written authorization from the Licensor approving of the work and the party performing such work before the Licensee shall install, remove, or provide maintenance of its communications facilities in any of Licensor's conduit systems. Licensor shall not withhold such authorization without good cause. Licensor retains the right

to specify what, if any, work shall be performed by Licensor at Licensee's expense.

E) In each instance where Licensee's communications facilities are to be placed in Licensor's conduit system, Licensor shall designate the particular duct(s) to be occupied, the location and manner in which Licensee's communications facilities will enter and exit Licensor's conduit system and the specific location and manner of installation for any associated equipment which is permitted by Licensor to occupy the conduit system. Licensor reserves the right to exclude or limit the type, number and size of Licensee's communications facilities which may be placed in Licensor's conduit system.

F) Licensor's manholes shall be opened only as permitted by Licensor's authorized employees or agents. Licensee shall be responsible for obtaining any necessary authorization from appropriate authorities to open manholes and conduct work operations therein. Licensee's employees, agents or contractors will be permitted to enter or work in Licensor's manholes only when an authorized employee or agent or Licensor is present or prior written authorization waiving this requirement is granted by the Licensor. Licensor's said employee or agent shall have the authority to suspend Licensee's work operations in and around Licensor's manholes if, in the sole discretion of said employee or agent any hazardous conditions arise or any unsafe practices are being followed by Licensee's employees, agents, or contractors. Licensee agrees to pay Licensor the charges, as determined in accordance with the terms and conditions of APPENDIX I, for having Licensor's employee or agent present when Licensee's work is being done in and around Licensor's manholes. The presence of Licensor's authorized employee or agent shall not relieve Licensee of its responsibility to conduct all

of its work operations in and around Licensor's manholes in a safe and workmanlike manner, in accordance with the terms of this Agreement.

G) Licensee, at its expense will remove its communications facilities from poles, anchors, or portions of a conduit system within 60 days after:

(1) termination of the license covering such attachment or conduit occupancy; or

(2) the date Licensee replaces its existing facilities on a pole with the placement of substitute facilities on the same pole or another pole, or replaces its existing facilities in one duct with the placement of substitute facilities in another duct.

Licensee shall remain liable for and pay to the Licensor all fees and charges pursuant to provisions of this Agreement until all of Licensee's facilities are physically removed from such poles, anchors and portions of conduit systems.

If Licensee fails to remove its facilities within the specified period, Licensor shall have the right to remove such facilities at Licensee's expense and without any liability on the part of the Licensor for damage to such facilities or without any liability for any interruption of Licensee's services.

When Licensee's communications facilities are removed from a pole, anchor or conduit system, no reattachment to the same pole or anchor or replacement in the same portion of a conduit system shall be made until:

(1) The Licensee has first complied with all of the provisions of this Agreement as though no such pole or anchor attachment or conduit occupancy had previously been made, and

(2) All outstanding charges due Licensor for such previous attachment and/or occupancy have been paid in full.

Licensee shall advise Licensor in writing as to the date on which the removal of its communications facilities from each pole, anchor, and/or portion of conduit system has been completed.

ARTICLE X

TERMINATION OF LICENSES

A) Any license issued under this Agreement shall automatically terminate when Licensee ceases to have authority to construct and operate its communications facilities on public or private property at the location of the particular pole, anchor, guy strand or portion of conduit system covered by the license.

B) Licensee may at any time terminate its license with respect to the attachment to a pole or anchor, utilization of a anchor/guy strand or occupancy of a portion of conduit system and remove its communications facilities by giving Licensor written notice of such intention (Forms E & F). Once Licensee's communications facilities have been removed they shall not be reattached to such pole or anchor, utilize such anchor/guy strand or occupy the same portion of a conduit system until Licensee has complied with all provisions of this Agreement as though no previous license has been issued.

* * * * *

ARTICLE XX

TERM OF AGREEMENT

A) Unless sooner terminated as herein provided, this Agreement shall continue in effect for a term of 1 year from the date hereof, and thereafter until

either party hereto terminates this agreement by giving the other party at least six months prior written notice thereof. Such six months notice of termination may be given to take effect at the end of the original 1 year period or thereafter.

B) Termination of this Agreement or any licenses issued hereunder shall not affect Licensee's liabilities and obligations incurred hereunder prior to the effective date of such termination.

* * * * *

APPENDIX I

SCHEDULE OF FEES AND CHARGES

THIS APPENDIX I, effective as of September 1, 1992, is an integral part of the License Agreement between THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA (Licensor) and CENTURY MOUNTAIN CORPORATION. (Licensee), dated September 1, 1992 and contains the fees and charges governing the use of Licensor's poles, anchors, guy strands and conduit system by Licensee's communications facilities.

A) *Attachment, Utilization, and Occupancy Fees*

1) *General*

a) Attachment, utilization, and occupancy fees commence on the first day of the calendar month following the date the license is issued for such attachment, utilization or occupancy. Such fees cease as of the final day of the calendar month preceding the month in which the attachment or occupancy is physically removed or the utilization is discontinued.

b) A one month minimum charge is applicable for all attachment, utilization and occupancy accommodations.

c) Fees shall be payable semi-annually in advance on the first day of January and July.

d) The total attachment, utilization and occupancy fees due hereunder, shall be based upon the number of poles, anchors, guy strands and duct feet of conduit for which licenses have been issued before the first day of December and the first day of June each year. Each semi-annual payment shall include

a proration of the monthly attachment, utilization and occupancy charges applicable for attachments, utilizations or occupancy initially authorized by the Licensor during the preceding six (6) month period.

2) *Fees*

Pole, Anchor, and/or Anchor/Guy Strand Accommodations — *Semi-Annual Fee*

a) Per pole attached — *$2.23

This fee is developed in accordance with the F.C.C. ruling in Winchester TV Cable Company vs. The Chesapeake and Potomac Telephone Company of Virginia, File No. PA-81-0045 using historical data from The Chesapeake and Potomac Telephone Company of Virginia. However, this ruling is under consideration by the F.C.C. and this fee may be adjusted to conform to any amended ruling.

Conduit Occupancy Accommodations — *Annual Fee*

b) Per foot of duct occupied

1.) Northern Virginia* — $5.25

2.) All other areas — $3.00

*Northern Virginia is defined as:
Arlington, Alexandria, Falls Church, McLean, Fairfax and Vienna.

c) For the purpose of determining the duct feet chargeable the duct considered occupied shall be measured from the:

(i) center to center of adjacent manholes, or

(ii) center of manhole to the end of a duct not terminated in a manhole.

B) *Charges*

1) *Computation*

Charges for all work performed by the Licensor or by its authorized representative in connection with the furnishing of pole, anchor, guy strand and conduit system accommodations as covered by this Agreement shall be based upon the full cost, plus 15% of such amount, to the Licensor for performance of such work. Such charges will apply for, but not be limited to, prelicense survey, make-ready work, inspection and removal of Licensee's communications facilities and supervision, at the option of the Licensor, of Licensee performed work in and around the immediate vicinity of a conduit system and poles.

2) *Pole, anchor and/or guy strand replacements*

The charge for replacement of a pole, anchor or guy strand required to accommodate Licensee's communications facilities, in accordance with ARTICLE VIII, A)8) shall be based on Licensor's fully installed costs less salvage value, if any.

C) *Payment Date*

Failure to pay all fees and charges within 30 days after presentment of the bill therefore or on the specified date, whichever is later, shall constitute a default of this Agreement.

CENTURY MOUNTAIN CORPORATION

By: /s/ [Illegible]

Its: Senior Vice President

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA

By: /s/ [Illegible]

Its: President & C.E.O.

GAO

United States General Accounting Office

Report to Congressional Requesters

February 1993

TELECOMMUNICATIONS

FCC's Oversight Efforts to Control Cross-Subsidization

[GAO Logo]

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-229035

February 3, 1993

The Honorable Mike Synar
House of Representatives

The Honorable Edward J. Markey
House of Representatives

Advances in technology and deregulation in the telecommunications industry have led to the evolution of companies (carriers) that provide both regulated and unregulated telecommunications services. Regulated services include basic interstate telephone service, and unregulated services include technologies, such as voice mail and electronic mail, that transmit computerized information over telephone lines. If carriers' costs for these two types of services are not properly allocated, customers of regulated telephone services (ratepayers) may be charged for some of the costs of the unregulated services. Such improper cost allocation is known as cross-subsidization.

In 1987, we reported that the Federal Communications Commisison (FCC) had not assigned enough staff to monitor carriers' cost allocations to protect ratepayers from cross-subsidization.[1] Specifically, we reported that at the then existing staffing level, FCC would be able to

[1] *Telephone Communications Controlling Cross-Subsidy Between Regulated and Competitive Services* (GAO/RCED-88-34, Oct. 23, 1987).

examine audit areas, such as time reporting and affiliate transactions, at the major carriers only once every 16 years. We recommended that FCC develop a strategy for increasing its oversight of carriers' cost allocations, emphasizing the importance of FCC's providing enough funds for personnel and travel to permit additional on-site audits. As requested, this report reviews FCC's implementation of (1) our recommendation to increase on-site audits of carriers' cost allocations and (2) certain accounting safeguards established after 1987 to protect ratepayers from cross-subsidization, including audits of carriers' cost allocations performed for the carriers by certified public accounting (CPA) firms, FCC's reviews of these audits, and a computerized system for maintaining carriers' cost and revenue data known as the Automated Reporting Management Information System (ARMIS).

Results in Brief

While FCC has submitted budget proposals requesting additional auditors several times since 1987, no additional positions have been allocated to the on-site audit function. For fiscal years 1990, 1991, 1992, and 1993, FCC asked the Office of Management and Budget (OMB) for 3, 3, 21, and 10 additional auditors, respectively. However, OMB asked the Congress for only three additional FCC auditors for 1990 and 1992 and did not ask for any additional auditors for 1991 and 1993. In the 1990 and 1991 budgets, the Congress approved funds that allowed FCC to increase its staffing level, but no additional positions were allocated to the on-site audit function.

In fact, on-site audit staff have declined since 1987, while the staff's work load has increased by 35 percent since the implementation of FCC's accounting safeguards. As of September 1992, the FCC staff of 14 auditors could, on average, cover the highest-priority audit areas once every 11 years and all audit areas once every 18 years. This level of coverage is inadequate because FCC cannot im-

pose any fines or penalties more than 5 years after a cost misallocation has occurred. Consequently, this staffing level cannot provide positive assurance that ratepayers are protected from cross-subsidization. Increasing the FCC staffing level, along with the appropriate travel funds, would have little or no effect on the federal budget because the government would be reimbursed for its on-site audits and reviews of CPA audits through fees FCC is authorized to collect from carriers.

Since 1987, FCC has established a number of additional safeguards that complement its on-site audits. Though useful, these safeguards have not detected all cases of cross-subsidization. CPA audits have extended FCC's audit coverage, but FCC auditors have found that they have often not been conducted in accordance with FCC guidance. Also, the FCC audit staffing level has not permitted reviews of all CPAs' audit workpapers and reports. Although ARMIS helped FCC to firmly identify one cross-subsidy problem, the system generally does not contain sufficiently precise and complete data to generate the comparisons of carriers' accounts that would allow FCC to readily identify potential cross-subsidy violations.

FCC auditors, through on-site audits, continue to detect instances of cross-subsidy that the other safeguards have not identified. For example, FCC's on-site audits uncovered cost misallocations totaling over $300 million that neither CPA audits nor FCC's reviews of the audits had found. While the other safeguards have limitations, FCC is studying ways to make carriers' cost allocation manuals uniform, which should increase the usefulness of the ARMIS data. Also, FCC has required CPA audits to implement further changes to improve compliance with FCC guidelines. However, on-site audits have demonstrated their effectiveness, and we continue to believe that additional on-site audit coverage is necessary to protect ratepayers' interests.

Background

During the 1960s, telephone and computer technologies became increasingly interdependent. Although FCC had regulated traditional interstate telecommunications since the 1930s, it did not control the new activities that delivered data-processing services over telephone lines. In 1980, FCC issued a decision that created a regulatory distinction between basic communications services and "enhanced" services, such as voice mail and electronic mail. Under this decision, enhanced services were not regulated and "customer premises equipment" (devices located on customers' premises that are used to send or receive information over the telephone network) were deregulated. (App. I lists common unregulated services.) Data reported to FCC by carriers for ARMIS indicate that the market for unregulated services currently generates about $3.5 billion in annual revenues.

Early in the development of enhanced services, FCC had recognized that carriers might pass on to telephone ratepayers costs properly attributable to the carriers' unregulated services. To prevent such improper cost shifting, FCC initially required carriers to offer unregulated services through separate corporate subsidiaries, which were to maintain their own financial records, staff, computer equipment, and facilities. Later, however, FCC substituted nonstructural requirements for the structural separation requirements it had imposed on carriers. In 1986, FCC applied these requirements to all major carriers, including the seven regional Bell Operating Companies (BOC) that were formed after the American Telephone and Telegraph Company (AT&T) divested itself of its local telephone operating companies in 1984.

FCC employs several accounting safeguards to look for cross-subsidization, including detailed on-site audits of carriers' records. For over a decade, FCC has used on-site

audits to meet its regulatory responsibilities—to determine whether carriers' practices and procedures (1) are in compliance with FCC standards and (2) are adequate to prevent cross-subsidization. In addition, on-site audits give FCC first-hand knowledge of carriers' cost allocation systems, serve as a check on CPA audits, and enable FCC to follow up on problems identified through other safeguards.

Since 1987, FCC has employed a number of accounting safeguards, including cost allocation standards prescribed by FCC; cost allocation manuals approved for carriers by FCC; annual independent audits performed by CPAS; FCC's reviews of these audits; and ARMIS, which FCC uses, among other things, to compare similar cost and revenue data between carriers. We did not review FCC's cost allocation standards or carriers' cost allocation manuals in this report. CPA audits are broad reviews performed for carriers in accordance with FCC guidance, often by the same firms that perform carriers' financial statement audits. Although CPAS are required to state whether carriers' cost allocation methodologies are consistent with carriers' cost allocation manuals, FCC determines, through its reviews of CPAS' workpapers and reports as well as through on-site visits, whether carriers' practices and procedures are in compliance with FCC standards. (See app. II for a more detailed discussion of FCC's regulatory actions and safeguards.)

The Accounting and Audits Division of FCC's Common Carrier Bureau is responsible for ensuring that telecommunications companies do not improperly allocate their costs. Fourteen auditors in the Audits Branch of that division are key staff responsible for oversight of carriers' cost allocations.

FCC Audit Staffing Level Is Not Adequate to Oversee Cost Allocations

In our 1987 report, we concluded that the cost allocation standards and procedures that FCC was developing and implementing were all essential. We maintained, however, that on-site audits were still necessary to protect consumers from cross-subsidization not only because cost allocation systems were inherently subjective but also because FCC had not yet tested the new safeguards.

At the time of our 1987 review, FCC's Audits Branch comprised 22 staff, including 3 supervisors, 2 secretaries, 1 statistician, 1 economist, and 15 auditors. We concluded that this staffing level was insufficient to ensure that consumers were protected against cross-subsidization, and we recommended that FCC increase its oversight through more on-site audits.

Since our previous review, FCC has not expanded its oversight of carriers' operations through on-site audits. Over the past 4 years, FCC has conducted generally about the same number of audits annually as we reported in 1987. Furthermore, the number of staff available to perform these audits has decreased. Although the number of auditors in FCC's Audits Branch remained stable through fiscal year 1988, it dropped to 12 in fiscal years 1989 and 1990 and then increased to 13 in fiscal year 1991. As of September 1992, FCC's Audits Branch consisted of 18 staff —3 supervisors, 1 secretary, and 14 auditors (see fig. 1). Meanwhile, the staff's work load has increased by 35 percent since the implementation of the accounting safeguards. Additional audit areas have been designated for on-site review, and FCC has expanded its reviews of CPAs' workpapers to ensure that the CPA audits meet FCC's regulatory needs. The Audits Branch's work load will further increase as the market for enhanced services grows and the volume of carriers' unregulated business increases.

[Figure Deleted]

FCC has acknowledged the limitations that its current audit staffing level imposes on its ability to detect cross-subsidization. In budget submissions for both fiscal years 1992 and 1993, FCC stated that this staffing level limits the assurance it can provide to the Congress and consumers that carriers are complying with cost allocation rules and that regulated services are not cross-subsidizing unregulated operations.

Since the issuance of our 1987 report, FCC has asked for additional auditors in four of its budget proposals to OMB. For fiscal years 1990 and 1991, FCC made proposals to increase the number of auditors by three for each fiscal year. However, OMB's congressional budget submissions for FCC asked for three additional auditors in 1990 and no additional auditors in 1991. Although the Congress approved 1990 and 1991 budgets, which allowed FCC to increase its staffing levels, no additional positions were allocated to the audit function. According to the former Chief of FCC's Common Carrier Bureau, he had identified other areas in the Bureau that needed more attention, and at the appropriate time, FCC would request the number of additional auditors it needed.

Subsequently, in budget requests for fiscal years 1992 and 1993, FCC asked OMB for additional auditors. FCC requested 21 additional auditors for fiscal year 1992, stating that this increase would enable the Audits Branch to review the highest-priority audit areas of each regional BOC and major independent carriers once every 5 years. The 5-year period is important because FCC cannot impose any fines or penalties more than 5 years after a cost misallocation has occurred. However, OMB reduced FCC's staffing request to three additional auditors in its fiscal year 1992 budget proposal to the Congress, and no additional staff were received as a result of that request. For fiscal

year 1993, FCC requested 10 additional auditors, stating that this increase would enable the Audits Branch to review the same significant audit areas once every 5 to 6 years. However, the fiscal year 1993 budget request that OMB submitted to the Congress contained no request for additional FCC audit staff.

To make more efficient use of existing staff, the Chief of Audits of FCC's Common Carrier Bureau has implemented a number of strategies: reducing the scope of on-site audits, reducing the size of audit teams from three to two persons where possible, targeting the most critical areas within the audit universe, and reviewing the CPA auditors' workpapers to identify potential cross-subsidies for targeting on-site audits. As an additional means of expanding its on-site audit coverage without increasing its own audit staff, FCC could consider engaging CPA firms to perform on-site audits at FCC's direction. We have not, however, evaluated the feasibility of such an approach.

Although increasing the number of FCC auditors, along with the appropriate travel funds, would increase FCC's budget, it would have little or no impact on the federal budget because FCC is authorized to charge fees to carriers for the on-site audits and reviews of CPA audits that it conducts. These fees, which are collected and deposited in the U.S. Treasury, would largely offset FCC's costs. Given the current staffing level, FCC's on-site audits of company books and records continue to be infrequent. On average, FCC annually audits about 16 of the 297 audit areas that it has designated for routine auditing to assess major carriers' compliance with FCC standards. At the present staffing level, FCC could cover each area once every 18 years. If FCC confined its efforts to the 183 areas that it has designated as most critical, it could audit each area about once every 11 years. The Chief of Audits of FCC's Common Carrier Bureau has estimated that a total of 45 auditors, along with the ap-

propriate travel funds, would be the ideal to permit on-site reviews of the most critical areas once every 5 years.

Additional Safeguards Can Be Useful, but On-Site Audits Are Still Needed

Since 1987, FCC has implemented a number of accounting safeguards to protect consumers from cross-subsidization, including (1) CPA audits of carriers' cost allocations; (2) FCC's reviews of CPAs' audit workpapers and reports; and (3) ARMIS, FCC's computerized system for maintaining carriers' cost and revenue data. Although these safeguards can give FCC useful information for monitoring carriers' operations, they have not detected all cases of cross-subsidization. Furthermore, as we noted in 1987, implementation of the safeguards does not diminish FCC's responsibility for ensuring the appropriateness of carriers' cost allocations. Finally, on-site audits have detected instances of cross-subsidization that the other safeguards have not found.

CPA Audits Frequently Have Not Been Performed in Compliance With FCC Guidance

CPA audits of cost allocation systems are required for 16 major carriers (AT&T and Tier I carriers, including the BOCs and all other local exchange carriers earning over $100 million annually in regulated revenue). In contrast to FCC's on-site audits, which review a carrier's cost allocations in a single audit area for as many as 5 years, CPA audits review a carrier's cost allocations in several related audit areas for 1 year. Whereas on-site audits emphasize detailed testing, CPA audits perform more general analyses of cost allocations in such broad

categories as affiliate transactions, time reporting, cost pools, enhanced services, and the uniform system of accounts, CPA audits are required to provide positive assurance as to whether the carriers' methodologies for separating regulated and unregulated costs are consistent with the cost allocation manuals approved for the carriers by FCC. The results of the CPA audits are reported to FCC's Common Carrier Bureau.

Although carriers hire CPA firms to perform CPA audits, FCC establishes requirements for the audits through its rules and through the guidelines that it develops in reviewing the CPAs' audit workpapers. FCC's authority to establish audit requirements is derived from regulations placed on carriers, which pass these requirements on to the CPA auditors. If a CPA audit is not performed in accordance with FCC guidelines and industry standards, FCC can prohibit a carrier from using that independent auditor for any future audit. In its rules, FCC has provided that CPAS are to follow *Generally Accepted Auditing Standards* except when these standards conflict with FCC rules.

In the order setting forth its accounting safeguards—known as the Joint Cost Order—FCC has provided that it will use CPA audits in its monitoring program but will itself make all final decisions regarding compliance. FCC will not delegate its responsibilities to the CPAS. As the order further states, the CPA audit process is an adjunct to, not a replacement for, FCC's on-site audit program.

CPA audits frequently have not been performed in compliance with FCC guidance, as FCC audit staff's reviews of 1990 workpapers for 17 audits have demonstrated. FCC staff identified at least one problem with 15 of 17 audits. Subsequently, FCC staff addressed the weaknesses in its guidance to carriers. The following examples illustrate some of the shortcomings that FCC audit staff found, the steps that they took to correct the shortcom-

ings, and—in some instances—the importance of their monitoring the CPA audits through on-site audits.

- FCC audit staff have found that CPAS' workpapers have not always adequately supported the findings from their audits. For example, FCC's review of a CPA audit disclosed that the workpapers did not provide the calculations and assumptions used to quantify its finding or show the effect of the finding on the allocation process. Thus, FCC concluded that the CPA could not support its conclusion and recommendation, nor could FCC make its own determination as to the seriousness of the finding. Our review of FCC's reports on 1990 CPA audits showed that problems with quantifying some findings of the audit work occurred in 10 of 17 audits. FCC audit staff have found that CPAS' testing has not always been adequate to ensure that carriers are complying with cost allocation rules. For example, in reviewing a CPA audit of an area for which FCC had already conducted an on-site audit, FCC found that the workpapers failed to show that the CPA had appropriately tested carrier employees' reporting of administrative time and telemarketing time. Using the information obtained from the on-site audit, FCC was able to require the carrier to make an adjustment to comply with FCC rules. Our review of FCC's reports on 1990 CPA audits showed that FCC had found detailed testing problems in 15 of 17 audits.

- FCC audit staff have found that CPA auditors have not always identified the materiality standards, or the amount of cost misallocation that the auditors consider sufficiently significant to warrant reporting. To ensure consistent and appropriate independent audits, FCC guidance requires CPAS to report these standards so that FCC can assess the suitability of the standards for the carriers. Our review of FCC's reports on 1990 CPA audits showed that FCC had found problems with

some aspect of reporting materiality standards in 11 of 17 audits.

- FCC audit staff have found that CPAs have not always adequately reviewed and tested the transactions of unregulated affiliate companies that provide substantially all of their services to a regulated affiliate company. Through information gained from on-site audits, FCC has identified components for testing and developed guidance and direction for CPA audits of affiliates' transactions. Our review of FCC's reports on 1990 CPA audits showed that FCC had identified problems with the CPAs' reviews of affiliate transactions in 13 of 17 audits.

FCC auditors are currently reviewing CPAs' workpapers for 1991 audits of carriers' cost allocation manuals. Although FCC believes the CPA audits have improved, further changes have been required to improve compliance with FCC guidelines. According to FCC audit staff, several of these changes have already been discussed in previous FCC communications. While recognizing that carriers may not have had time to comply with all of the new requirements for their 1991 CPA audits, FCC staff expect the requirements to be implemented in the 1992 audits.

In fiscal year 1993, independent CPA audits will cover 183, or about 62 percent, of the 297 audit areas that FCC has designated for all major carriers. FCC itself will perform on-site audits of only 15 audit areas covered by the CPAs. (See fig. 2.) Four of these audits will be performed only if the Audits Branch receives supplemental travel funds.

(Figure Deleted)

FCC's Reviews of CPAs' Workpapers and Audit Reports Are Not Complete

FCC oversees CPA audits and audit procedures by reviewing auditors' workpapers and audit reports, as well as by conducting on-site audits. In principle, these reviews enable FCC to ensure that the CPA audits are being, or have been, conducted in accordance with FCC specifications and therefore will be, or are, adequate to determine carriers' compliance. These reviews also enable FCC to identify weaknesses in its own guidance and to revise its requirements for CPA audits. For example, following reviews of CPA auditors' 1988 and 1989 workpapers, FCC determined that the CPA audit should be expanded to meet the standards applicable to a financial statement audit.

Because staffing limitations restrict FCC's oversight of CPA audits through on-site audits, FCC relies extensively on reviews of CPAs' workpapers to evaluate the reliability of the CPAs' work. Yet even these reviews have been limited. For the last 3 years in which review cycles have been completed, FCC auditors have been able to complete the reviews of workpapers for only 43 of the 58 CPA audits performed. Furthermore, FCC has reviewed five carriers' CPA audits only once. For fiscal year 1991, FCC had planned to review all 20 CPA audits in order to determine CPAs' compliance with new FCC guidelines. As of September 1992, FCC had completed reviews of 17 of the 20 CPA audits and performed some work on the remaining 3.

ARMIS Data Are Not Uniform

ARMIS is a computerized system containing cost, revenue, and forecast data reported by major carriers that FCC uses for a variety of its regulatory functions. FCC had anticipated that ARMIS would allow it to track trends in cost

data over time and across companies, establish benchmarks for comparison, identify disproportionate cost allocations indicative of potential cross-subsidization, and target on-site audits to carriers whose allocations appeared problematic.

For several reasons, ARMIS has not generated the comparisons that would have allowed FCC to substitute "computerized auditing" for some on-site audits. First, ARMIS does not break out cost pool data—that is, report regulated and unregulated costs for individual subaccounts—because cost pools vary from one carrier to another. Therefore, only aggregate (and less useful) comparisons are possible. In addition, each carrier's cost allocation manual contains different procedures for allocating certain costs, and carriers change these procedures throughout the year with FCC's approval. According to the Chief of Accounting Systems of FCC's Common Carrier Bureau, FCC is currently studying ways to make the cost allocation manuals uniform. He also said that if the cost allocation manuals had more uniform standards for cost pools and cost allocation procedures, then the automated reporting system could be more useful in identifying possible instances of cross-subsidy.

Despite its limitations, ARMIS did enable FCC to detect "inside wire" misallocations amounting to over $200 million. Charges for time spent by service representatives locating trouble with indoor telephone wires were inappropriately allocated to regulated services. After deregulating inside wiring and making homeowners responsible for repairs to it, FCC was expecting the regulated account balances to decrease. When ARMIS data did not reflect the anticipated decrease, FCC auditors made on-site visits to determine the extent of the misallocation. According to FCC officials, this was the only instance in which ARMIS data had enabled them to firmly identify a cost misallocation for follow-up by FCC auditors. There have

been instances in other regulatory areas where ARMIS was used to identify problems.

Through on-site audits, FCC auditors have identified cost misallocations that neither CPA audits nor FCC's reviews of CPAs' workpapers and audit reports had disclosed. For example, FCC auditors have found cases of misallocations totaling over $300 million in which carriers charged expenses to the regulated side of their businesses and carriers' affiliates had overcharged regulated carriers for services and supplies.

On-site audits have enabled FCC auditors to detect not only cost misallocations but also deficiencies in carriers' cost allocation procedures and in CPAs' audit practices and procedures. For example, in reviewing one carrier's time reporting, FCC auditors found that for a 3-year period the carrier's employees had not followed the proper procedures for allocating their time to regulated and unregulated services. The CPA was aware of the carrier's procedures, but the CPA believed it was in compliance with FCC rules. FCC auditors disagreed and required the carrier to make the appropriate changes. Because the carrier had not followed FCC's procedures and the CPA firm had not enforced FCC's procedures, about $130 million had been charged erroneously to the regulated services. Following the on-site audit, FCC auditors required the carrier to reallocate the costs that it had improperly charged to the regulated services and to revise its procedures to conform with FCC's policies and procedures.

Conclusions

In 1987, we reported that FCC had insufficient staff to ensure that consumers were protected from cross-subsidization. Since that time, FCC's responsibility for overseeing carriers' cost allocations have continued to grow, but the staff resources allocated to this function have declined rather than increased. We believe the num-

ber of FCC auditors remains inadequate to provide a positive assurance that ratepayers are protected from cross-subsidization.

Increasing the FCC staffing level, along with the appropriate travel funds, would have little or no impact on the federal budget because the government would be reimbursed for its on-site audits and reviews of CPA audits through fees FCC is authorized to collect from carriers. Given this trend of increasing work load and decreasing resources, the potential exists for ratepayers to be more vulnerable to inappropriate charges resulting from cross-subsidization in the future. Although CPA audits, FCC's reviews of these audits, and ARMIS can give FCC useful information for monitoring, they have not identified over $300 million in cross-subsidization. Further refinements to FCC audit guidance and greater uniformity in reporting cost data for ARMIS may improve FCC's information for oversight, but expanded coverage through additional on-site audits by FCC would give ratepayers and the Congress greater assurance that cross-subsidization is not occurring.

Recommendation to the Chairman, Federal Communications Commission

We recommend that the Chairman, FCC, continue to pursue the Commission's quest for additional resources to improve assurance that cross-subsidization is not taking place.

Matter for Congressional Consideration

The Congress may wish to consider authorizing additional permanent positions for auditors and the appropriate travel funds, recognizing that the funds expended would have little or no impact on the federal budget.

Agency Comments and Our Evaluation

We discussed the information contained in this report with the Deputy Chief of FCC's Common Carrier Bureau and his staff. They generally agreed with the factual information in the report, and we have incorporated their comments where appropriate . As requested, we did not obtain written agency comments on a draft of this report.

The Commission's position is that all the safeguards taken together are an effective deterrent against cross-subsidization. However, as pointed out in this report, FCC audit staff continue to find significant problems in the audits that they have been able to conduct. It is our view that the FCC audit staffing level is not adequate to oversee cost allocations, and the additional safeguards FCC employs have not been effective in detecting all cases of cross-subsidization. Consequently, we continue to believe that our recommendation that FCC continue to seek the additional resources is valid.

To update our 1987 report and determine whether FCC had increased its oversight of carriers' operations as we had recommended, we reviewed FCC's efforts to obtain additional audit staff and examined FCC's implementation of nonstructural accounting safeguards. We performed our work in accordance with generally accepted government auditing standards from September 1991 through September 1992. Appendix III contains further discussion of our objectives, scope, and methodology.

As arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies of this report to interested congressional committees and subcommittees; individual Members of Congress; the Chairman, Federal Communications Commission; the Director, Office of Management

and Budget; and other interested parties. We will make copies available to others on request.

This work was performed under the direction of Kenneth M. Mead, Director, Transportation Issues, who can be reached at (202) 275-1000 if you or your staff have any questions. Major contributors to this report are listed in appendix IV.

/s/ J. Dexter Peach
J. DEXTER PEACH
Assistant Comptroller General

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

C.A. Dkt. No. 92-1751-A

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA, ET AL., PLAINTIFFS

v.

UNITED STATES OF AMERICA, ET AL., DEFENDANTS

AFFIDAVIT OF ROBERT W. LUCKY

Robert W. Lucky deposes and says:

1. I am currently Vice President, Applied Research, at Bell Communications Research (Bellcore). I have a Ph.D in electrical engineering from Purdue University. I spent three decades at Bell Labs, where I was responsible for, among other things, research on the methods and technologies for future communications systems, including optical fiber technology, data networks, mobile communications, image processing, and broadband communications technologies and services. I have written numerous books and articles, and received numerous awards, including the Marconi Prize for contributions to data communications. In 1993, I was inducted into the New Jersey Inventors Hall of Fame at the New Jersey Institute of Technology. I have served as President of the Communications Society of the IEEE (Institute of Electrical and Electronics Engineers), and as Vice President and Executive Vice President of the parent IEEE itself.

2. Most cable systems today are operated in the broadcast mode: one centralized transmitter dispatches

information to thousands of identical receivers. By contrast, voice telephone service is two-way and interactive. Any subscriber can communicate personally with any other subscriber.

3. Until very recently, video television signals were delivered to households over a form of metal wire called "coaxial cable." Coaxial cable was the best medium available for distributing one-way video signals to consumers. The broadcast networks deployed by cable companies were not suitable for providing two-way voice telephone service. Telephone service was provided, instead, over "twisted pair" copper wires. Cable and telephone wires were physically different. Coaxial cable consisted of a metal wire running down the middle of cylindrical metal sheath. "Twisted pair" telephone wiring consisted of two identical copper wires twisted together in a double helix.

4. Both telephone companies and cable companies are now replacing metal wires with fiber-optic glass cable. Signals are translated into digital form (as a series of on-off pulses) and transmitted as flashing laser light through thin strands of very pure glass. Fiber optic communication systems handle video, voice, and data in exactly the same way. The information is all digital. It is transmitted over the same facilities, in the same way, whether it represents a rerun of "I Love Lucy," a phone call on Mother's Day, or a stock quote from Wall Street.

5. For example, East Buchanan Telephone in Winthrop, Iowa, has about 600 cable and 1,300 telephone subscribers, served over a single backbone network that was upgraded to fiber in Spring 1992.[1] The FCC has likewise permitted GTE to build and maintain an integrated, high-capacity test network in Cerritos, California,[2] which

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[1] L. Ellis, *What's Happening Under the Cross-ownership Fence,* Communications Engineering and Design, Mar. 1993, at 64.

[2] General Telephone Co. of California, 64 Rad. Reg.2d (P & F) 1156 (Common Carrier Bur. 1988), *aff'd,* 4 F.C.C. Rcd 5693 (1989),

will eventually provide voice, video, and data signals by way of fiber, coaxial, and copper wire, to 5,000 homes. In the Cascades development community in Loudoun County, Virginia, the C&P Telephone Company of Virginia is providing transport for video programming of third parties using fiber optic technology. Bell Atlantic has also announced an agreement to provide fiber-optic video transport to almost 12,000 households in Florham Park, Madison and Chatham, New Jersey.[3] In Dover, New Jersey Bell has announced a similar plan to provide fibre-optic video transport to approximately 38,000 residences, in competition with the incumbent CATV operator.[4]

6. Even as they deploy glass fiber, both cable companies and telephone companies are deploying new technologies to upgrade the capabilities of their existing metal-wire networks.

7. Recently developed new technologies permit telephone companies to transport full-motion color video programs directly to subscribers over the existing telephone network. A new technology known as ADSL

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remanded sub nom. National Cable Television Ass'n, Inc. v. FCC, 914 F.2d 285 (D.C. Cir. 1990).

[3] Application, *In re* Application of NEW JERSEY BELL TELEPHONE COMPANY For authority pursuant to Section 214 of the Communications Act of 1934, as amended, to construct, operate, own, and maintain, advanced fiber optic facilities and equipment to provide video dial tone service within a geographically defined area in the municipalities of Florham Park Borough, Madison Borough, and Chatham Borough, New Jersey, File No. W-P-C 6838 (F.C.C. Nov. 16, 1992).

[4] Application, *In re* Application of NEW JERSEY BELL TELEPHONE COMPANY For authority pursuant to Section 214 of the Communications Act of 1934, as amended, to construct, operate, own, and maintain, advanced fiber optic facilities and equipment to provide video dial tone service within a geographically defined area in Dover Township, Ocean County, New Jersey, File No. W-P-C 6840 (F.C.C. Dec. 15, 1992).

(Asymmetric Digital Subscriber Line) makes possible the simultaneous transmission of both voice and video signals over existing copper telephone wires. This marks a major, and potentially very important advance in technology—one that was wholly unforeseen a decade ago. ADSL is already being deployed in service trials. Bell Atlantic has recently been granted permission by the FCC to test ADSL technology in 400 homes in Northern Virginia.[5]

8. For their part, cable companies are grafting two-way voice capabilities on to their networks. A new generation of radio phones, much like existing cellular phones but smaller and cheaper, is now being licensed by the FCC. Cable interests have become leading developers of these "personal communications services." According to estimates cited in August 1992 by the FCC, these radio-based systems may well provide telephone service to 60 million American subscribers by the end of the 1990s.[6] For example, a major cable company (Time Warner) recently made a presentation to financial analysts in which it described its plans to deploy a full-service, voice, video, and data network.[7]

9. In sum, the technology of both cable and telephony has evolved dramatically in the last decade. A decade

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[5] Application, *In re* Application of THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA For authority pursuant to Section 214 of the Communications Act of 1934, as amended, to construct, operate, own, and maintain, facilities and equipment to test a new technology for use in providing video dial tone within a geographically defined trial area in Northern Virginia, File No. W-P-C 6834 (F.C.C. Oct. 21, 1992).

[6] *In re* Commission's Rules to Establish New Personal Communications Services, 7 F.C.C. Rcd 5676, 5697 (1992) (citing *Market Researchers See Large Demand for PCS in U.S.*, Microcell News, Mar. 25, 1992.).

[7] *Time Warner to Build Data Network in Fla.*, Reuters, Jan. 26, 1993, Financial Report.

ago, cable and telephone used different kinds of metal wires. Today, both are deploying glass. A decade ago, different types of metal-wire network supported different types of transmission. Today, new technology permits video over existing telephone wires, and voice over a combination of radio and cable.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed the 26th day of April, 1993.

/s/ Robert W. Lucky
ROBERT W. LUCKY
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IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

[Caption Omitted in Printing]

AFFIDAVIT OF WILLIAM E. LEE

1. My name is William E. Lee. I am a Professor in the Henry W. Grady College of Journalism and Mass Communication at the University of Georgia. I earned a Doctorate degree in Mass Communications at the University of Wisconsin in 1977 and have been on the faculty at the University of Georgia since 1977. I have taught courses on the structure and practices of the mass media and have published extensively on mass communication. I have testified as an expert on mass communication at seven trials and have provided expert testimony through affidavits or depositions in seven other lawsuits. The matters set forth and the opinions expressed herein are known or personally held by me and if called as a witness, I could testify competently to them.

2. Based on my background in the field of mass communication, I make three principal points in this affidavit. First, the creation, selection, arrangement, packaging and provision of video programming for multichannel delivery, whether it is performed by a cable company or by Bell Atlantic Video Services ("BVS"), involves editorial decisions that are functionally indistinguishable from those involved in newspaper editing. Second, today video communication is the most important mass medium in America. Third, the ban against telephone company provision of "video programming" at issue in this lawsuit cannot be understood or enforced without reference to, and gov-

ernment scrutiny of, the content of individual programs or services.

I. *Editorial Decision-Making By Multichannel Video Programmers and Newspapers*

3. Based on my review of the pleadings in this case and on discussions with employees of BVS, I have gained an understanding of the nature of the services that BVS intends to provide. Specifically, BVS intends to provide a multichannel package of video programming directly to consumers. Although BVS will use the common carrier telephone network of The Chesapeake and Potomac Telephone Company of Virginia ("C&P") to deliver this programming, BVS itself will not act in any sense as a common carrier. Rather, BVS will exercise complete editorial discretion over the package of programming it will provide, whether BVS decides to create programming of its own, or selects, assembles, edits and arranges video programming obtained from others. In this respect, BVS will perform the same editorial functions performed by cable operators in selecting and packaging the programming provided over their cable systems. As I will explain below, moreover, the editorial functions performed by BVS and other multichannel programmers are indistinguishable from those performed by newspapers.

Multichannel Video Programmers

4. At the outset, it is important to point out that multichannel video programmers exercise editorial discretion in two separate respects. First, these programmers exercise editorial discretion in choosing the programming they will provide. Second, once this initial selection is made, multichannel programmers exercise editorial discretion in arranging and packaging this programming for sale to consumers. I address each of these functions below.

5. Multichannel video programmers must choose among available programming options because of both technical and financial constraints. Currently most multichannel video programming is delivered over cable systems that have limited channel capacity, and the supply of available programming exceeds the capacity of virtually all cable systems. Even apart from these capacity limitations, however, multichannel video programmers also face financial constraints on the number and types of video programs for which consumers will pay. As a result, multichannel programmers must exercise discretion to choose among the available programming options.

6. Multichannel video programmers make programming decisions based upon two distinct strategies. Some programming services, such as broadcast stations, are selected because of their appeal to broad segments of the audience. Other programming services, like Black Entertainment Television, are selected because they appeal to narrow racial, ethnic, age, or interest groups. Some programming services are identified with particular subjects and viewpoints. For example, the Family Channel offers a different view on sexual morality than does the Playboy at Night service. The interest of audience segments in certain topics and viewpoints influences the selection of programming. The primary programming options for multichannel video programmers are briefly described below:

a. Multichannel video programmers select which broadcast stations to carry. The selection of broadcast stations is affected by the number and nature of stations in the local and adjacent markets, and by whether (and how much) a multichannel provider must pay for "retransmission" rights for a broadcaster's signal. Since the most-watched sources on cable are the major network (ABC, CBS and NBC) broadcast affiliates, multichannel video programmers naturally retransmit the signals of local affiliates. However, a multichannel video program-

mer may wish to carry two affiliates of the same network located in adjacent markets. Although the network programming on both stations will be duplicative, the additional station is selected because of factors such as audience interest in news from the adjacent market. Multichannel video programmers must also determine which local independent stations to retransmit. For example, a suburban cable system may prefer not to carry an independent television station that broadcasts in a foreign language that is of interest only to urban residents. Every broadcast signal that is carried reduces the options the programmer has for other types of programming.

b. Multichannel video programmers also select among cable programming services such as the 75 plus basic cable network, 42 regional networks, 7 pay cable networks, 7 pay-per-view networks, 10 text services, and 11 audio services. (Attachment A lists the available cable programming services.) While some of these services seek to reach broad audiences, others are "niche" services that appeal to a very limited age or interest group. In 1991-92, 43% of viewing time in cable households was devoted to basic and pay cable services. *See* Stipulation 8. The audience for each service, therefore, represents a very small portion (often less than 1%) of the total audience; selection of the appropriate mix of services entails the identification of small groups whose interests are not served by other sources.

c. Currently, approximately forty-one percent of cable systems in the United States carry locally originated programming. *TV & Cable Factbook, Services Volume* at I-68 (1993 edition). The types of local programs include sports, comedy, children's, talk, music, and news. Because a cable system serves a more limited geographic area than the multi-country region served by a television station, a cable system is able to provide programming more closely tailored to the interests of a particular town. For example, one of the most significant recent developments in local cable programming is the coverage of local

news. A broadcast television station's news necessarily focuses on the major city in the television market, such as Washington, D.C., or on stories of regional interest, but provides little coverage of the many smaller communities located within the station's market. A cable system, however, can fill in the news "niches" left untouched by broadcast television news. Thus, local cable news is merging in places like Long Island, New York and Orange County, California that are largely ignored by broadcast television news. These cable news operations range in size from the twenty-four-hour service in Long Island, to daily half-hour newscasts in communities such as Ithaca, New York, to brief inserts of local news in CNN Headline News. The cost of producing local news coverage, however, is a major obstacle to the development of these services. *See, e.g.*, "Local News Stymies Many Cable Firms," *Wall Street Journal*, June 15, 1991, at B1. To control costs, multichannel video programmers are entering cooperative arrangements with local broadcasters and newspaper publishers. For example, some broadcasters prepare coverage of elections just for dissemination on cable. *See, e.g.*, "KYW-TV Election Coverage: Via Cable Systems," *"Broadcasting*, November 4, 1991, at 48 (describing Philadelphia, Pennsylvania television station's arrangement with local cable systems). Some multichannel video programmers allow either local broadcasters or newspapers to insert a brief summary of local news in a cable program service such as Headline News or a weather update in the Weather Channel. *See, e.g.*, "System Teams Up with Local Paper, Broadcaster," *Multichannel News*, August 20, 1990, at 14 (describing Rock Hill, South Carolina cable system's arrangement).

7. In addition, once the multichannel video programmer selects the programming it will provide, it must package the programming for sale to consumers. In doing so, the programmer exercises editorial discretion both in terms of determining where particular programming is positioned in the channel lineup, and in terms of determining

which programming to include in particular packages. For example, the programmer must decide which programming to include in a "basic" package, in more inclusive packages, and as "premium" services.

8. In summary, whether deciding to carry material produced by others, whether and how to cover local events, or how to arrange and package programming for sale, multichannel video programmers make choices about the programming content offered to subscribers. Such choices are affected by audience demographics, audience interests, ideology, and technological and financial constraints. The process of editorial choice engaged in by multichannel video programmers is no different than that engaged in by newspapers.

Newspapers

9. As in the case with multichannel video programmers, newspaper publishers also face constraints on the amount and type of news content included in their papers. The most important source of newspaper revenue is from the sale of advertising space; 78% of a newspaper's revenue comes from advertising, with the remaining 22% from subscriptions. *The Veronis, Suhler & Associates Communications Industry Forecast* at 39 (1992). Consequently, the amount of news and feature content is usually determined by the number of advertisements that have been sold. The typical newshole—the space allocated to news and features—is about 40% of a newspaper's content. J. Dominick, *The Dynamics of Mass Communication* at 203 (2nd ed. 1987). On a heavy advertising day, the newshole may be only 25% of the paper's contents. D. Pember, *Mass Media in America* at 59 (4th ed. 1983). Newspaper editors, thus, must carefully select the newshole content from among the available options.

10. Like multichannel video programmers, contemporary newspapers provide information of interest to a

general audience as well as information of interest to segments of the audience, such as cooking, science, and finance. Through readership studies, editors seek to identify both the general and special interests of the audience; news content is a product designed to be purchased by readers. Newspaper editorial costs typically range from 14 and 22% of total costs. J. Udell, *The Economics of the American Newspaper* at 122 (1978). Because editors must stay within a budget, the relative cost of various types of content is a factor in selecting material. For example, the use of syndicated or news service material may cost less than material written by the newspaper's staff.

11. The primary newshole options available to a newspaper are briefly described below:

a. With the exceptions of very large circulation newspapers, typical newspapers rely upon news services such as the Associated Press for national and international news. Information from these services can be rewritten by the newspaper's staff, or carried without alteration. A 1986 study found that Associated Press member papers fill 37% of their newsholes with AP copy. C. Fink, *Strategic Newspaper Management* at 167 (1988). There are approximately 142 news and picture services available to newspapers. *Editor & Publisher International Yearbook* at V-1-6 (1992).

b. Newspapers also rely upon feature syndicates for material such as cartoons, editorial cartoons, sports box scores, weather maps, and columnists. This material is provided to the newspaper in a form that is ready to print, and is generally carried without editing by the newspaper. Syndicated material may fill up to 18% of the newshole. Since hundreds of newspapers buy from a syndiate, the cost to a newspaper for these features is relatively low; the cost of hiring a columnist to write solely for one newspaper is greater than the cost of buying a syndicated column. There are approximately 417

entities offering syndicated material to newspapers. *Editor & Publisher International Yearbook* at V-7-12 (1992).

c. Many Sunday newspapers include preprinted inserts such as comics sections, magazines like *Parade*, and television listings such as *TV Log*. Newspapers make no alteration of the content of these sections; the material is prepared and printed elsewhere and merely included within the newspaper. The choice the newspaper makes is whether to have such a section, and if so, which of the available services should be selected. A newspaper serving a community that is heavily Hispanic may chose *Vista—The Hispanic Magazine* over *Parade*, but does not alter or edit the selected magazine. There are 12 comics sections, and 10 magazines available to newspapers. *Editor & Publisher International Yearbook* at V-12-17 (1992).

d. Editors may assign reporters to cover local events. News policies, such as avoiding negative references about major advertisers, influence coverage. *See* L. Solely & R. Craig, "Advertising Pressures on Newspapers," 21 *J. of Advertising* 1 (1992). The perception of what is news, based on analysis of factors such as timeliness, proximity, prominence, consequence, and human interest, also determines what events the newspaper assigns reporters to cover. Cost also influences local coverage; some stories, such as those involving lengthy investigations, cost more to prepare than others.

12. In summary, like multinational video programmers, newspapers frequently carry material prepared by others. The newspapers nonetheless exercise editorial discretion by determining in the first instance whether the material should be published, and also in determining the editorial arrangement of the content. Whether selecting and arranging material provided by others, or deciding how to cover local news, newspaper content is affected by audience demographics, audience interests, ideology, and technological and financial constraints, just as the content

of a multichannel video programmer's package of programming is affected by these same factors.

BVS's Services

13. Based on the understanding I have gained of the nature of the services BVS intends to offer, it is also clear that BVS's editorial process is comparable to that of newspapers and of other multichannel video programmers. It merits noting that my opinion expressed in this affidavit is not affected by the content of particular programs BVS intends to offer. Instead my opinion is based on the kinds of activities in which BVS is currently engaged.

14. In preparing its programming plan, BVS conducted research concerning audience demographics, and completed its own proprietary marketing survey of Alexandria residents. In addition, the company acquired reports of meetings of the Alexandria Cable Television Advisory Commission, as well as the results of a survey of cable subscribers conducted by Jones Intercable, the incumbent cable operator.

15. Through this research BVS learned that consumers are interested in specific services not offered by Jones Intercable. For example, in 1992 Jones deleted all of the Baltimore television stations it carried to make room for four cable program services. BVS intends to offer those Baltimore stations to its subscribers. BVS also learned of subscriber interest in WGN, a Chicago superstation, and as a result intends to offer it to subscribers. In response to consumer interest in greater variety, BVS will offer more local and adjacent-market broadcast signals, basic cable networks, and premium cable networks, than does Jones. Finally, BVS found that there was significant audience interest in video-on-demand, a service that permits consumers to order any one of potentially hundreds of programs from a library of stored videos for viewing at any time. This is also a service that is not offered by Jones.

16. Although BVS seeks to offer diverse programming, the company has established editorial standards governing the portrayal of sex and violence. The community accepts the level of sex and violence offered on services such as HBO. More explicit material, however, will not be offered. Based on these standards, the company has decided not to carry Spice or Playboy at Night, two sexually explicit programming services. The standards governing sex and violence will also be used in the selection of material to be included in the video library. Standards governing other types of content will be developed in conjunction with the community as the company gains experience with video programming. BVS intends to sell advertising time and will have standards on advertising content similar to those of local broadcasters.

17. In creating the video library for its video-on-demand service, BVS intends to arrange the programming it chooses for inclusion into six categories: entertainment, living, learning, buying, communication, and information seeking. Each segment is further divided into a number of subdivisions. For example, within the entertainment segment are subdivisions for movies, sports, and video games. The video library provides consumers with a significant increase in programming options. However, "shelf space" within the library is not infinite. Thus, BVS must carefully select the programming included in the video library to reflect audience interests, community standards, and creative judgments.

18. BVS's editorial discretion concerning the development of the video library operates at several levels. First, the company selected the segments to be included. Second, it selected the specific programming services, or individual programs, to be made available to consumers. Third, BVS is arranging categories, subdivisions, and navigational aids to guide the consumer in a manner similar to that in which a newspaper lays out its sections and

pages. Fourth, to aid the user, BVS is prioritizing menu listings. For example, within a subcategory such as action-adventure films, BVS will offer a listing of "top" films, as well as a more inclusive listing. Fifth, BSV is packaging programs according to themes, and is combining programs for "best of" presentations. Thus, while some viewers may be interested in all of the episodes of "Cheers," others may prefer BVS's compilation of what it regards as the best episodes. Sixth, reflecting its concern for parental control over children's use of the library, BVS is organizing material according to age categories and is offering parents the ability to "lock-out" certain segments, subdivisions, and program sources. Seventh, because there is community interest in specific types of local programs, BVS will make equipment and studios for the production of local programming available; this programming will be archived in the video library.

19. In summary, BVS's editorial decision-making is the same as that of other multichannel video programmers or newspapers. The company's decisions concerning which programming services to offer are based on market studies that reveal consumer interests unmet by the incumbent cable operator. Moreover, the company has adopted standards, based on community attitudes, concerning depictions of sex and violence. BVS is also exercising editorial discretion in the selection and packaging of the video library.

II. *The Significance of Video Programming As A Medium of Mass Communication*

20. The importance of video programming as a medium of mass communication today is beyond dispute. Video programming is now the dominant means by which people obtain news, information and entertainment. Whether one thinks in terms of television coverage of important events such as the Watergate hearings, the Gulf

War or political campaigns, or in terms of video entertainment including movies such as "Dances With Wolves" that combine gripping visual imagery with important social messages, video programming communicates messages and ideas in a manner that cannot be fully duplicated through use of print or audio media alone. Moreover, while these are not matters that are subject to any dispute, the importance of video programming can be illustrated by reference to empirical data.

21. For example, the importance of video programming as a medium of communication is illustrated by comparing the amount of time people spend with various media, the amount of money people spend on various media, and the amount of money advertisers spend on various media. Specifically, Tables I-IV in Attachment B reveal that in 1991 consumers spent more time with broadcast and cable television than any other medium, and spent more money on cable subscriptions than on the purchase of any other media product. While newspapers remain the largest single advertising vehicle, in 1991 the total advertising and consumer expenditures on broadcast and cable television, $41.8 billion, exceeded the total advertising and consumer expenditures on daily newspapers, $39.6 billion, by $2.2 billion. The amount spent on video tape rentals and purchases in 1991 exceeded box office revenues by $6.1 billion.

22. It is also important to note a number of trends concerning media usage. First, the percentage of adults reading newspapers daily has been declining, and was at 62% in 1991. *The Veronis, Suhler & Associates Communications Industry Forecast* at 171 (1992). Second, cable penetration as a percentage of television households has increased markedly to over 60% today. Accompanying the increase in cable penetration has been a shift in viewing patterns. Broadcast stations' share of total television viewing has declined from 87% in 1986 to 73.5% in 1991. In the same period basic and pay cable services'

share of total television viewing has increased from 13% to 26.5%. *Id.* at 77. In households that subscribe to cable, moreover, 43% of viewing time was devoted to cable-originated programming as of 1991-92. Third, the percentage of television households with a VCR has increased from 37.8% in 1986 to 73.7% in 1991. *Id.* at 127. Expenditures on the rental and purchase of prerecorded video tapes have increased from $5 billion in 1986 to $10.9 billion in 1991. *Id.*

23. Television has become the dominant news source for most Americans. Television is a main news source for 66% of Americans, compared to 36% for newspapers and 14% for radio. The Roper Organization, *America's Watching: Public Attitudes Toward Television* at 18 (1987) (respondents were allowed to mention more than one medium as a main news source, thus the percentages add up to more than 100). The increasing reliance on television news is explained in part by its credibility. Since 1961 television has been perceived as the most credible news medium, and its lead continues to increase. *Id.* at 5. A February 1993 poll revealed that the Cable News Network (CNN) was the most believable news source, followed closely by ABC, CBS, and NBC. Times Mirror Center for the People and the Press, *Times Mirror News Interest Index* at 1 (March 3, 1993). Daily newspapers were considered to be less believable than CNN and the major broadcast networks. *Id.* Significantly, although NBC News was damaged by the revelation that it staged the explosion of a General Motors truck, it was still regarded as more believable than daily newspapers. *Id.*

24. Television is especially important as a means of political communication. It has become the dominant source of both national and local political news. The Roper Organization, *America's Watching: Public Attitudes Toward Television* at 6-7 (1987). It has altered how

campaign resources are expended, how campaign organizations are structured, and how compaigns are conducted. Because of the heavy expenditures on television advertising by politicians, the costs of campaigning have increased. In fact, the largest category of expenditure for House, Senate, and Presidential campaigns is for television advertising. *See, e.g.*, S. Fritz & D. Morris, *Handbook of Campaign Spending: Money in the 1990 Congressional Races* at 53-57 (Cong. Q. 1992). *See generally* E. Diamond & S. Bates, *The Spot: The Rise of Political Advertising on Television* (1988 ed.). Nominating conventions and campaign activities are organized for television coverage. Campaign staffs typically include consultants who advise the candidate on his or her television image. *See* M. McCubbins, ed., *Under the Watchful Eye: Managing Presidential Campaigns in the Television Era* (1992). Although the impact of these developments on voting behavior is not clear, the behavior of candidates reveals that they regard television as the critical means of cultivating voter awareness.

25. While providing news and entertainment, television functions as a socialization agent by transmitting values, presenting role models, and communicating acceptable behaviors. The relative importance of television as a socializing agent is underscored by the medium's pervasiveness and accessibility, and by the amount of time people spend viewing. Ninety-eight percent of all American homes have television and the average home has 2.1 sets. U.S. Dept. of Commerce, Bureau of Census, *Statistical Abstract of the United States 1992* Table 884 (112th ed. 1992). Television is accessible to all income and educational groups. In contrast, newspaper consumption requires literacy, and increases as education and income levels increase. *Id.* at Table 885. Television's accessibility is also enhanced by its low hourly costs to users; even when cable subscriptions are included, total television viewing cost only 6 cents per person per hour in 1991. By comparison, newspapers cost

29 cents per hour, magazines cost 38 cents per hour, and books cost 69 cents per hour. *The Veronis, Suhler & Associates Communications Industry Forecast* at 14 (1992). And as Table I illustrates, people spend more time with television than any other medium. No medium in our society transmits as many social cues, to as many people, as frequently, as does television.

26. The combination of sight and sound in video programming provided by television make it a distinctive communications medium. Television can depict the real world, but it also can create images and sounds that are "unreal." Television's visual images change rapidly, through techniques such as cutting between cameras, zooms and pans; through the use of special effects; and through the image manipulation made possible by advances in computer technology. Television dialogue may be life-like, but the audio portion of television may also include enriching features like musical accompaniment and sound effects. These audio and visual techniques sustain interest in the program, but also convey meaning. For example, children quickly learn that a fade or dissolve signals a change in time or location. Researchers have posited that this combination of visual and auditory components make television distinct from other media. *See, e.g.*, A. Huston & J. Wright, "Children's Processing of Television: The Informative Functions of Formal Features," in J. Bryant & D. Anderson, eds., *Children's Understanding of Television* (1983). The communicative features of the video programming that is provided over television are unmatched by print, photographs, or radio.

27. A multichannel video service, such as that proposed by BVS, provides a unique communication environment. The programmer may employ distinctive programming strategies, such as seeking to reach both broad and narrow audience segments. As a result, audience members may employ a range of information-seeking strategies, driven by general or highly specialized interests. In addition, the

proposed video-on-demand feature enables the consumer to access an extraordinary range of video information without the time constraints posed by broadcast station or cable channel scheduling. Most importantly, video-on-demand permits viewers to more efficiently seek information relevant to them. Video-on-demand transforms the customary television-viewing question from "What's on tv?" to "What can *I* put on tv?"

III. *Enforcing the Video Ban Requires Government Scrutiny of Program Content*

28. When Congress created the ban on "video programming" in 1984, it defined the subject of its prohibition to include video programming "provided by, or generally considered comparable to" video programming provided by broadcast stations. This prohibition can only be understood or enforced by reference to, and government scrutiny of, the content of individual programs or services that telephone companies provide.

29. The very language chosen by Congress emphasizes the need for government officials interpreting and enforcing the ban to exercise their subjective judgment to determine if a particular program is forbidden "video programming." The ban does not apply to all "video images." Nor does its apply to particular technologies, such as over-the-air broadcast technologies. Rather, the ban focuses on the content of the service being provided. If, in the judgment of the appropriate government officials, the program would be "generally considered comparable to" programming provided by broadcasters, then it is forbidden. If in their subjective judgment the program would not be considered comparable, then it is permitted.

30. In today's environment of rapidly changing technologies, government officials will frequently be called upon to exercise their judgment as to what is and what is not "video programming." Unlike 1984, when voice,

data and video were largely discrete services delivered using separate technologies, these services are no longer discrete, nor are they delivered using different technologies. For example, services available today can mix voice, data, text and video together in a variety of combinations. These services range from relatively simple videotext services such as airline guides that can be displayed either on television or personal computer screens, to complicated multi-media services that are fully interactive. But whether these services, or other new services that are being or will be developed, qualify as "video programming" turns upon a subjective view of whether the content of the service is "comparable to" programming provided by broadcasters.

31. Moreover, the concern that the statute will set government officials up to act as censors of what is and is not permitted is not a speculative one. The scope of the ban has been the subject of considerable dispute, and has been extensively litigated before the FCC. Without regard to whether the FCC's chosen interpretation of the scope of the ban is correct or incorrect, the efforts of the FCC to grapple with the problem serve to illustrate the basic point that the ban can only be understood through reference to the content of particular programs.

32. Specifically, in its 1992 "Video Dialtone" order, the FCC was called upon to address whether some of the new services containing video images qualify as "video programming." As an initial matter, however, the Commission had to determine the appropriate reference point for comparing these services to programming provided by broadcasters. Based on the legislative history, the Commission interpreted the statutory language to mean that "Congress intended to prohibit only telephone company provision of programming comparable to that provided by broadcast stations in *1984*." *Telephone Company-Cable Television Cross-Ownership Rules*, 7 FCC Rcd 5781, 5820 (1992). *See also* 130 Cong. Rec. H12235 (daily ed. Oct. 11, 1984) (the House notes that the term "video

programming" refers to programming generally provided by a television broadcast station *today*).

33. In deference to the subjective nature of the statutory ban, the FCC adopted what it described as a "severability" standard. This standard considers whether a particular service is interactive, but does not consider this factor to be determinative. According to the FCC, "to the extent a service contains severable video images capable of being provided as independent video programs comparable to those provided by broadcast stations in 1984, that portion of the programming service will be deemed to constitute 'video programming' . . . ." 7 FCC Rcd at 5821. As a result, telephone companies are permitted to provide the underlying technical capabilities that make an interactive service work, but may still be barred from providing the actual programming content for the service if, in the FCC's subjective opinion, it is comparable to programming provided by broadcasters.

34. The Commission elaborated on its "severability" test by offering some examples:

> —According to the FCC, a shopping service or "video catalogue" that allows consumers to "electronically request specific goods and services would not constitute prohibited video programming, even if the service incorporated video images. In such a case, the video images would not be severable from the interactivity." *Id.* at 5822. But home shopping programs, even those enabling the consumer to order a product electronically, would be prohibited if they resemble home shopping programs broadcast in 1984. *Id.*
>
> —Likewise, an educational multimedia presentation containing video images is generally permissible as long as it includes enough textual or graphic information and interactivity that the content demonstrably differs from what broadcasters provided in

1984, but "the simple inclusion of some textual information" would not transform a "severable video program into a permissible multimedia program." *Id.* at 5822 n.196.

—Providing the video programming content for interactive pay-per-view and video-on-demand services is prohibited because the programming is severable from the function of ordering programming; but strictly one-way services such as videotext news services, stock market information, on-line airline guides, and downloading of video games and computer software are permissible because the content of these services is sufficiently different from programming provided by broadcasters. *Id.* at 5822-23 & n.199.

35. None of these distinctions between permissible and impermissible programming can be maintained by reference to technical considerations. For example, there is not technological basis for distinguishing one form of multimedia tele-shopping from another. Video and audio information can be delivered over telephone lines, cable, and other media, displayed on a personal computer or a television receiver. All formats offer instant ordering capability. Consequently, a ban on home-video shopping of the kind provided by television in 1984 can be enforced only by a highly subjective comparison of the content of contemporary programs with programs from 1984. The same subjective comparison occurs with other types of services, and the need for these subjective comparisons will increase. In 1984, a video news program with occasional text captions was recognizably different from a videotext service like NEXIS that was provided over a telephone line. But with today's merging media formats, it is possible to deliver text, pictures, sound, and interactive search-and-selection capabilities through a variety of delivery systems. In short, the only way the FCC can distinguish between impermissible "video programming" and permissible programming is to examine the content

frame by frame, sound bite by sound bite, caption by caption, with the kind of programming offered on television in 1984.

/s/ Wm. E. Lee
WILLIAM E. LEE

[Notarization Omitted in Printing]

ATTACHMENT A

CABLE PROGRAMMING SERVICES

AUDIO ONLY

AEI MUSIC NETWORK
BIBLE BROADCASTING NETWORK
CABLE RADIO NETWORK
DIGITAL CABLE RADIO
DIGITAL MUSIC EXPRESS
GALACTIC RADIO
KLON LOS ANGELES-THE JAZZ NETWORK
MOODY BROADCASTING NETWORK
MUTUAL BROADCASTING SYSTEM INC.
SATELLITE RADIO NETWORK
WFMT CHICAGO

CANADIAN

CATHAY INTERNATIONAL TELEVISION
FIRST CHOICE—THE MOVIE NETWORK
MUCHMUSIC NETWORK
LE RESEAU DES SPORTS
THE SPORTS NETWORK
STORYVISION NETWORK
SUPERCHANNEL

PAY SERVICES

CINEMAX
THE DISNEY CHANNEL
ENCORE
HOME BOX OFFICE INC. (HBO)
THE MOVIE CHANNNEL
PLAYBOY AT NIGHT
SHOWTIME NETWORKS INC.

PAY-PER-VIEW

ACTION PAY-PER-VIEW
CABLE VIDEO STORE
GUEST CINEMA
REQUEST TELEVISION
SPICE
VIEWER'S CHOICE
VIEWER'S CHOICE II

REGIONAL PROGRAMMING

ARIZONA SPORTS PROGRAMMING
ATLANTA INTERFAITH
CABLE TV NETWORK OF NEW JERSEY INC.
ECUMENICAL TV CHANNEL
EMPIRE SPORTS NETWORK
HOME SPORTS ENTERTAINMENT
HOME TEAM SPORTS
IOWA CABLE NETWORK
JEWISH TELEVISION NETWORK
KBL SPORTS NETWORK
MADISON SQUARE GARDEN NETWORK
MEADOWS RACING NETWORK
MIDWEST SPORTS CHANNEL
NEW ENGLAND CABLE NEWS
NEW ENGLAND SPORTS NETWORK
NEW YORK 1 NEWS
NEWS 12 LONG ISLAND
NEWSCHANNEL 8
NIPPON GOLDEN NETWORK
ORANGE COUNTY NEWSCHANNEL
PENNARAMA
PENN NATIONAL RACING ALIVE
PHILADELPHIA PARK LIVE
PRIME SPORTS NETWORK
PRIME TICKET NETWORK
PRISM
PRO AM SPORTS SYSTEM
RTP—USA
RURAL ALASKA TELEVISION NETWORK
SAN DIEGO CABLE SPORTS NETWORK
SATELLITE SPORTS NETWORK
SPORTSCHANNEL CHICAGO
SPORTSCHANNEL FLORIDA
SPORTSCHANNEL LOS ANGELES
SPORTSCHANNEL NEW ENGLAND
SPORTSCHANNEL NEW YORK
SPORTSCHANNEL OHIO
SPORTSCHANNEL PACIFIC
SPORTSCHANNEL PENNSYLVANIA
SPORTSCHANNEL NETWORK
SUNSHINE NETWORK
TSC-THE SPORTS CHANNEL

SATELLITE PROGRAMMERS

ACTS SATELLITE NETWORK
ALL NEWS CHANNEL

ALTERNATIVE VIEW NETWORK
AMERICA'S DISABILITY CHANNEL/THE
SILENT NETWORK
AMERICAN MOVIE CLASSICS
THE ARABIC CHANNEL
ARTS & ENTERTAINMENT TELEVISION
BIZNET
BLACK ENTERTAINMENT TELEVISION
THE BOX
BRAVO
CABLE NEWS NETWORK
CABLE SATELLITE PUBLIC AFFAIRS NETWORK
C-SPAN 2
CANCOM
CNBC
COKESBURY SATELLITE NETWORK
COMEDY CENTRAL
COUNTRY MUSIC TELEVISION
COURT TV
DEEP DISH TV NETWORK
DISCOVERY CHANNEL
E! ENTERTAINMENT TV
ESPN INC.
ETERNAL WORD TV NETWORK
THE FAMILY CHANNEL
FAMILYNET
GALAVISION
GOLDEN AMERICAN NETWORK
THE GREEK CHANNEL
HEADLINE NEWS
HIT VIDEO USA
HOME SHOPPING NETWORK
HOME SHOPPING NETWORK 2
HSNE
INTERNATIONAL CHANNEL
INTERNATIONAL TELEVISION BROADCASTING
KEYSTONE INSPIRATIONAL NETWORK
THE KOREAN CHANNEL
KTLA LOS ANGELES
KTVT DALLAS
THE LEARNING CHANNEL
LIFETIME
MIND EXTENSION U
MTV: MUSIC TELEVISION
NASA SELECT
THE NASHVILLE NETWORK
NATIONAL JEWISH TV
NETLINK USA

THE NEW INSPIRATIONAL NETWORK
NICK AT NITE
NICKELODEON
NOSTALGIA TELEVISION
PREVUE GUIDE
PRIMETIME 24
PUBLIC INTEREST VIDEO NETWORK
QVC FASHION CHANNEL
QVC NETWORK INC.
RAI-USA
REUTERS NEWS-VIEW
RUSSIAN TELEVISION NETWORK INC.
SCI-FI CHANNEL
SCOLA
SHALOM AMERICA
SHEPHERDS CHAPEL NETWORK
SPORTSCHANNEL AMERICA
TELECOLOMBIA
THE TRAVEL CHANNEL
TRINITY BROADCASTING NETWORK
TURNER NETWORK TV
TV JAPAN
UNIVISION
USA NETWORK
VIDEO HITS ONE (VH-1)
VISION INTERFAITH SATELLITE NETWORK
THE WEATHER CHANNEL
WEB SPORTS WIRE
WGN-TV/UVI
WPIX NEW YORK
WSBK-TV BOSTON
WTBS ATLANTA
WWOR-TV NEW YORK

TEXT SERVICES

CABLE SPORTSTRACKER
THE ELECTRONIC PROGRAM GUIDE
ELECTRONIC PROGRAM GUIDE JR.
LIFE NEWSVISION
TMS BUSINESS PLUS
TMS NEWS PLUS
TMS SPORTS PLUS
UPI DATACABLE
X*PRESS EXECUTIVE
X*PRESS X*CHANGE

Source: *Television & Cable Factbook, Services Volume* at G-65 (1993 edition).

ATTACHMENT B

TABLE I
Hours Per Person Per Year Using Various Media
(1991)

Medium	*Hours*
Television (total)	1,515
Network Affiliated Stations	848
Independent Stations	265
Basic Cable	319
Pay Cable	83
Radio	1,115
Recorded Music	219
Daily Newspapers	169
Magazines	88
Books	98
Home Video	43
Movies in Theaters	9
Total	3,256

Source: *The Veronis, Suhler & Associates Communications Industry Forecast* at 12 (1992).

TABLE II

End-User Spending Per Person Per Year
For Various Media
(1991)

Medium	*Amount* ($)
Cable Television	84.13
Movie Box Office	23.03
Home Video	58.56
Recorded Music	37.57
Daily Newspapers	49.02
Books	67.83
Magazines	33.02
Total	353.16

Source: *The Veronis, Suhler & Associates Communications Industry Forecast* at 14 (1992). Broadcast television and radio are excluded from this comparison because they are supported entirely by advertising.

TABLE III

Advertising Expenditure by Medium
(1991)

Medium	*Amount* ($ Mil)
Television Broadcasting	24,110
Radio Broadcasting	8,450
Cable Television	1,985
Daily Newspapers	30,409
Magazines	10,635

Source: *The Veronis, Suhler & Associates Communications Industry Forecast* at 23 (1992). Media that are not supported in part by advertising, such as films, recorded music, and books are excluded from this comparison.

TABLE IV

Gross Media Expenditures
(1991)

Industry Segment	*Amount* ($ Mil)
Television Broadcasting	24,110
Radio Broadcasting	8,450
Cable Television	17,780
Movie Box Office	4,803
Home Video	10,995
Recorded Music	7,834
Daily Newspapers	39,612
Book Publishing	20,265
Magazine Publishing	18,335

Source: *The Veronis, Suhler & Associates Communications Industry Forecast* at 23 (1992). The expenditures included for this comparison include both end-user and advertising expenditures.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

[Caption Omitted in Printing]

AFFIDAVIT OF RICHARD A. ALSTON

1. I am Vice President—Operations & Engineering for The Chesapeake & Potomac Telephone Company of Virginia ("C&P"). I have had extensive experience in network operations in my career over the past 21 years with C&P and with other parts of the former Bell System.

2. C&P is proposing to enhance its telephone network in Alexandria, Virginia to have the capability of carrying video programming upon the successful outcome of this litigation.

3. If C&P made these enhancements today, C&P would use a fiber optic system supplied by BroadBand Technologies, Inc., which carries both telephone calls and video signals on an integrated basis. C&P currently is using this system to carry the video programming of third parties at the Cascades development in Loudoun County, Virginia. A sister company of C&P, the New Jersey Bell Telephone Company, has announced that it will use this system to carry the video programming of third parties in several areas in New Jersey.

4. Using the BroadBand Technologies, Inc. system, C&P's network in Alexandria would have the capacity to provide several hundred channels of video programming to its telephone subscribers.

5. In addition, C&P's network would have the capability to deliver video programs on demand. This will allow consumers to select one of potentially hundreds of

movies or other programs from video libraries to view at any given time of the consumer's choosing.

6. If permitted by this Court, C&P would make these capabilities available to its affiliate, Bell Atlantic Video Services Company ("BVS"), so that BVS can provide video programming to subscribers in Alexandria. C&P would also make these capabilities available for use by other video programmers under tariff on a common carrier basis.

7. In providing these services, C&P will not exercise editorial control over the unaffiliated programmers that use its network—with the exception of the possible exclusion of pornography or other offensive material to the extent that such exclusion is permitted under common carrier regulation.

8. C&P, to the extent permitted by the FCC, may also offer some limited video programming of its own such as introductory menus or welcoming screens.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on April 27, 1993.

/s/ Richard A. Alston
RICHARD A. ALSTON

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

[Caption Omitted in Printing]

AFFIDAVIT OF DR. VIVIAN M. HORNER

1. I am Director of Bell Atlantic Video Services Company ("BVS") and part of the team that is developing video programming for BVS to provide in Alexandria and elsewhere.

2. I have more than thirty years of programming and communications experience, primarily in start-up ventures. Among other positions, I was formerly Vice President, Program Development, of Warner Amex Cable Communications, where I created several highly-successful video programming services, including Pinwheel (a channel for preschool children), Sight on Sound (the precursor of MTV), and Nickelodeon.

3. If permitted at the end of this case, BVS will provide video programming in Alexandria using the C&P telephone network. BVS will purchase capacity from C&P on the same tariffed terms as offered by C&P to others.

4. BVS will select and package some of its programming from the numerous cable programming networks that are available; it will also select some programming from various film libraries and from independent producers.

5. In addition, some programming may be produced exclusively for BVS by producers working under contract with BVS or by BVS employees themselves. Bell Atlantic has three broadcast-quality television studios located in

Silver Spring, Philadelphia, and Newark which BVS may use to produce programming.

6. BVS also will carry broadcast programming.

7. The programming that BVS will provide in Alexandria is based on a review of audience demographics and interests, community standards, and BVS's and my own editorial judgments. BVS will exercise editorial control over the programming that it provides.

8. BVS is currently engaged in discussions with a number of suppliers of video programming. No supplier that BVS has talked to has refused to supply programming. To the contrary, suppliers are eager to open up an alternative distribution channel.

9. BVS plans to provide programming that is not currently available in Alexandria. For example, BVS plans to carry several Spanish language channels such as Canal SUR, Galavision/ECO, Telemundo, and Univision. According to the 1990 census, 9.7% of Alexandria residents are Hispanic. The Alexandria Public Schools offer instruction in English as a second language; the largest block of students in these programs speak Spanish as their primary language. Jones carries only one Spanish language broadcast station (W48AC) and none of the other available Spanish language programming. As another example, BVS plans to carry WGN, a Chicago broadcast superstation that carries Cubs baseball games. According to a 1992 survey Jones conducted, Alexandria cable subscribers would like to receive WGN. Jones, however, does not carry it.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on 4/28/93.

/s/ Vivian M. Horner
DR. VIVIAN M. HORNER

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

[Caption Omitted in Printing]

AFFIDAVIT OF THOMAS W. HAZLETT

Thomas W. Hazlett deposes and says:

1. I am an Associate Professor at the University of California, Davis, where I teach economics and public policy. During the 1991-1992 academic year I served as Chief Economist of the Federal Communications Commisison. During the 1990-1991 academic year I was a Visiting Scholar at the Columbia Institute for Tele-Information at the Columbia University Graduate School of Business.

2. I received my Ph.D. in economics from UCLA in 1984 and have taught a variety of courses in micro-economics, finance, and public policy at the graduate and undergraduate levels. I have researched and written numerous academic articles on competitive and regulatory issues in the cable and broadcast television industries. The Appendix to this affidavit includes a list of my publications relevant to this affidavit.

Summary

3. In this affidavit I explain the fundamental changes that have transformed the cable industry in the years since the FCC promulgated the CATV ban in 1970 and even since 1984, when Congress codified it. The original ban dates back to a time when cable was still a fledgling industry, thought to be highly susceptible to dominance by telephone companies through their control of utility

poles and other rights-of-way needed for coaxial cable used to provide cable service. But today, following the passage of the Pole Attachment Act and two decades of sheltered growth, the cable industry has become a powerful monopolist in its own right, exercising market power over viewers and extracting monopoly profits that reduce the general flow of video programming. In these circumstances, permitting entry by the telephone companies can only lead to lower prices and increased output (*i.e.*, to more consumer choice and additional communication services).

The Existing Cable Companies Have Monopolized Local Video Distribution

4. Cable television systems generally operate as monopolies in the local markets in which they serve. These monopolies developed into dominant distributors of video programming largely over the last decade.

5. The cable industry was born in Mahanoy City, Pennsylvania in 1948. In the 1950s, the FCC twice declined to regulate cable systems as common carriers.[1]

6. In 1970, the FCC decided to shelter the infant cable industry from telephone company competition. Accordingly, the FCC prohibited telephone companies from providing CATV service. The FCC also took steps to facilitate cable company access to telephone company poles and conduits.[2]

7. Congress followed with the federal Pole Attachment Act of 1978.[3] This legislation authorized the FCC, in combination with state regulation, to regulate the rates

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[1] *See* Lucas Powe, Jr., *American Broadcasting and the First Amendment* 218-220 (1987).

[2] *See generally* Siegel, *The History of Cable Television Pole Attachment Regulation*, 6 Comm. and the Law 9 (Dec. 1984).

[3] Pub. Law No. 95-234, Communications Act Amendments of 1978 (Feb. 6, 1978), *codified in* 47 U.S.C. § 224.

cable companies were charged for pole access.[4] The Commission established a mathematical formula for determining "just and reasonable" attachment rates,[5] and set up a procedure to encourage private resolution of most disputes.[6] Access remains, in principle, a matter of contract negotiation.[7] But mutually satisfactory contracts were soon hammered out.[8]

8. Cable television developed rapidly in the late 1970s and early 1980s. Major cable networks such as ESPN (1979), Nickelodeon (1979), and CNN (1980) were launched. Cable subscribership began to grow rapidly. Table 1.

9. A further impetus to investment in cable plant and in satellite networks was provided by the 1984 Cable Act, which deregulated cable rates, fully unleashing the industry to compete against broadcast television. Congress also incorporated into the Act a revised version of the FCC's ban on cable service.

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[4] "[T]he Commission shall regulate the rates, terms, and conditions for pole attachments to provide that such rates, terms, and conditions are just and reasonable * * *." 47 U.S.C § 224(b)(1). The Act also provided that a state would not be considered to be regulating pole attachments unless it had issued rules and was acting promptly on complaints. *Id.* at § 224(c)(3).

[5] Subpart J. Pole Attachment Complaint Procedures, 47 U.S.C. § 1.1409(c).

[6] *Id.* at § 1.1404.

[7] *See FCC* v. *Florida Power Corp.*, 480 U.S. 245, 251 n.6 (1987). "CATV industry representatives" had testified "that access to utility poles does not in itself constitute a problem." S. Rep. No. 580, at 16.

[8] *National Cable Television Ass'n* v. *FCC*, 747 F.2d 1503, 1505, 1506 & n.1 (D.C. Cir. 1984). *See also* Telephone Company-Cable Television Cross-Ownership Rules, §§ 63.54-63.58, Telco Notice of Inquiry, 2 F.C.C. Rcd 5092, 5093-5094 (1987) (discussing ameliorating effect of the Pole Attachment Act).

10. The growth in distribution plant has also been dramatic. In 1970 cable was available to less than 10 percent of all American television households.[9] By 1984 it passed approximately 72 percent of all television households. Cable now passes 96 percent of television households. Subscribership to cable increased from less than 7 percent of all U.S. homes in 1970 to nearly 44 percent in 1984. By 1992, about 60 percent of U.S. households subscribed.[10] Programming distributed principally over cable systems began in 1972 with HBO. There were four national cable networks in existence in 1976. By 1984 this number had increased to 49 and by 1992 to 78. Table 2.

11. The cable industry benefitted enormously from deregulation. Capital values in the industry grew; average selling prices for cable systems rose from an average of $948 per subscriber in 1984 to $2,291 per subscriber in 1989. Table 3. While macroeconomic factors flattened asset values generally in 1990-1992, recent 1993 cable transactions indicate that per subscriber transactions are again well over $2,000.

12. It is now clear that by the late 1980s the cable industry had acquired substantial market power over the local distribution of video programming. The best evidence of this monopolistic profitability is found in the economic "Q-ratios." In a competitive industry, buyers won't pay much more to buy facilities than it would cost to build them from scratch. Thus, in a competitive industry, the market value of an asset is generally approximated by its replacement cost of capital. The Q-ratio is an economic measure based on this logic. The ratio is defined as:

> Q=Market Value/Replacement Cost of Tangible Capital

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[9] Stip. 17.

[10] Stip. 17.

13. In the cable television industry, Q-ratios have been estimated at between 2.5 and 6.[11] These estimates are supported by basic facts. The typical cable network costs about $619 per subscriber to build.[12] Yet investors buying cable assets over the past five years have paid about $2,000 per subscriber, or about three times the price that a highly competitive firm would attract in the marketplace. In fact, the average Q-ratio for the firms listed on the New York Stock Exchange in February 1990 was only .85.[13] A 1990 Brookings Institute study of 20 industries over the 1961-1985 time period found an average Q-ratio of 1.28 throughout the 25-year time frame, and just one industry with a Q-ratio of more than 2.[14] And, in a study of Q-ratios conducted for the United States Telephone Association, Paul MacAvoy estimated that Q-ratios for GTE and the seven Regional Bell Operating Companies (including their cellular holdings) ranged from 1.1 to 1.3, with a weighted average of 1.2.[15]

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[11] These estimates are summarized in Thomas W. Hazlett, *Duopolistic Competition in Cable Television: Implications for Public Policy*, VII Yale J. on Reg. 97-99 (Winter 1990).

[12] Capital costs are derived from a June 1986 Department of Justice, Antitrust Division, Economic Analysis Group paper by Albert Smiley. This is detailed in Thomas W. Hazlett, *Duopolistic Competition in Cable Television: Implications for Public Policy*, VII Yale J. on Reg. 98 (Winter 1990).

[13] *In re* Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, 5 F.C.C. Rcd 4962, 4999 (1990) (MM Dkt. No. 89-600) (hereinafter FCC Cable Report).

[14] Lawrence F. Katz & Lawrence H. Summers, *Industry Rents: Evidence and Implications*, in *Brookings Papers on Economic Activity: Microeconomics* 214 (1989).

[15] MacAvoy noted that, excluding cellular holdings, the ratio would be closer to 1.0. *See* FCC Cable Report, 5 F.C.C. Rcd at 5074. As the FCC has observed, this ratio "reflects [the telcos'] status as regulated utilities." *Ibid.*

14. When cable companies face competition in their service areas, their monopoly power dissipates. Over the 1988-1992 period, there are twenty-one recorded sales transactions for cable companies in competitive (duopolistic) markets. They average 15-20 percent less on a per subscriber basis than contemporaneous sales of cable systems in monopoly markets. Table 4.

15. In response to widespread dissatisfiaction with rising cable prices, poor customer service, and complaints concerning monopolistic practices, the U.S. Congress enacted a cable re-regulation bill in 1992.[16]

16. The likely effects of this bill can be debated.[17] What is abundantly clear, however, is that virtually all the major policy discussion about the video distribution industry now centers on how to constrain cable's market power. Public concerns about cable's competitive viability have, due to changing market conditions, become entirely obsolete.

Head-to-Head Cable Rivalry Lowers Prices and Increases Output for Consumers

17. Compelling evidence of cable's power to raise rates due to a monopoly market structure comes from those few communities that have permitted and enjoyed head-to-head cable competition. There, prices are reliably lower and output (measured by subscribership or number of channels offered) is higher. In data released by the FCC in February 1993, 46 cable systems in head-to-

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[16] Pub. Law No. 102-385 (Oct. 5, 1992), *codified in* 47 U.S.C. § 521.

[17] I have argued elsewhere that the "reregulation" portion of the 1992 Act is not likely to be effective, although the rules attempting to open up local markets to competition are a step in the right direction. *See* T. Hazlett, *In Cable War, Consumers Get Snagged*, Wall St. J., Oct. 2, 1992 (op-ed page); T. Hazlett, *Cable Reregulation: The Episodes You Didn't See on C-SPAN*, Regulation Magazine, 1993 (forthcoming).

head competitive markets were found to have charged basic prices of just $0.41 per channel, contrasted to a rate of $0.65 per channel on monopoly systems. Cable systems that faced competition featured both lower basic cable rates and more channels. Table 5.

18. Several earlier surveys have found similar results. In 1990, the FCC surveyed a number of competitive systems, and found that their rates were 34 percent below monopoly system prices on a per channel basis.[18] The Commission was led to conclude that "direct competition has resulted in reduced per channel rates for cable service."[19] In a 1990 econometric study, Levin & Meisel found basic cable prices from 22 percent to 30 percent lower for a service which "typically includes more channels."[20] And, while difficult to measure, narrative accounts strongly suggest that customer service in competitive markets is also superior.[21]

19. Data from Paul Kagan Associates further support the price-lowering effect of head-to-head rivalry. In an April 1992 survey of 103 systems competing in 50 separate cable markets and serving 1.13 million households (about 2 percent of the U.S. cable total), the average revenue per subscriber was $25.08,[22] while the average number of channels offered on basic was 40. The

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[18] FCC Cable Report, 5 F.C.C. Rcd 4962, at App. H-2.

[19] *Id.* at 5014.

[20] Stanford L. Levin & John B. Meisel, *Cable Television and Telecommunications: Theory, Evidence and Policy*, Telecommunications Policy, Dec. 1990, at 519-528.

[21] Daniel R. Levine, *Behind the Cable Rip-off: It's Time to Pull the Plug on Price-Gouging Monopolies and Get a Little Healthy Competition into the Picture*, Reader's Digest, June 1992; Mark Lewyn & Julie Ampano Lopez, *More Choice for Cable TV?*, Business Week, May 13, 1991.

[22] Kagan breaks down the data into "incumbent" and "overbuilder" categories. The figures used here are equally weighted averages of the two.

average monthly revenue per subscriber for all U.S. cable systems in 1992 was $32.12 (Table 1) and the number of basic channels offered was under 35 (Table 5), implying that competitive systems were pricing their total service package about 21.9 percent lower, while providing greater viewing choices. Table 6.

20. Incumbent cable companies respond dramatically to new competition. When an entrant begins constructing a competing system, the incumbent typically cuts subscriber rates just in those areas (literally, the blocks) where the competitor has placed its lines. Prices have been dramatically lower in areas where rivalry has been in evidence, a sign that prices prior to entry were above competitive levels. Telesat Cablevision, for example, entered the cable market against entrenched competitors in Orange County, Florida. In April 1992, the prices charged by the two firms against which Telesat competed (in different areas of Orange County) were far lower than the prices they charged in their monopoly markets. Table 7.

21. In sum, the evidence is overwhelming that a monopoly market structure allows cable firms to charge consumers higher prices than otherwise. Cable's Q-ratios, prices in cross-sectional studies, prices in time series, and system sales prices under competitive vs. monopoly market structures all point in exactly the same direction: cable firms that face no direct competition from head-to-head cable competitors have significant market power which they utilize to raise rates and restrict output from competitive levels.

Jones Intercable Enjoys a Monopoly Position in Alexandria, Virginia

22. Jones Intercable enjoys a market position in Alexandria, Virginia typical of cable franchisees elsewhere in the country. As the sole cable television system in the city, it enjoys a Q ratio significantly above 1. In fact,

in an intracompany transfer in 1992, Jones paid $2,134 per subscriber.[23] The purchase price is clearly in excess of capital replacement costs, particularly considering that the density of households is more than *twice* the national average (thus reducing plant investment per subscriber).

23. Jones' rates in Alexandria, where it does not face head-to-head cable competition, are significantly higher than in Anne Arundel, Maryland, a market in which Jones does face a direct cable competitor.[24] The monthly price of the basic cable package in Alexandria is $24.65, and includes 44 channels of programming. In Anne Arundel, Jones charges $21.20, and offers subscribers either 43 or 53 channels, depending upon where they live.[25] This indicates that prices in the competitive market are between 8 percent and 29 percent lower on a per-channel basis. Such downward pressure on prices reliably expands the consumption of any product. The relative cable subscribership rates in Alexandria and Anne Arundel are consistent with this. Cable subscribership in Alexandria is only 57 percent, which is less than the national average. In Anne Arundel County, cable subscribership is over 70 percent, well above the national average.[26]

24. A comparison of the prices Jones charges in Alexandria with national averages compiled by the FCC (see Table 4) reveals that Jones charges about 37 percent more per channel for basic services in Alexandria than do cable companies that face head-to-head competition. This despite the fact that the density of households in

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[23] Dean Witter Reynolds, Company Report—Jones Intercable Investor, L.P. 4 (Oct. 22, 1992). The report claims that the "[p]rice paid for Alexandria Systems seems low." *Ibid.*

[24] The competitor, United Cable and its predecessors, have competed with Jones for more than a decade by virtue of each company holding a non-exclusive cable franchise.

[25] Stip. 34.

[26] Stip. 35.

Alexandria is more than twice the national average, which substantially reduces plant investment per subscriber.

Direct Cable Competition is Financially Viable

25. Cable monopolies dominate local video markets not due to an efficient market structure, which realizes scale economies for the benefit of consumers. Quite the contrary: cable companies currently charge prices far in excess of their average costs, as well as the likely costs of competitors. New entrants could charge lower prices and still realize profits. Head-to-head cable competition is viable in most local cable markets at existing prices, and even at prices much reduced from current monopoly levels.

26. Video programming currently available vastly exceeds the carrying capacities of existing cable systems. There are roughly 80 national programming networks currently available.[27] In total, over 150 channels of cable programming are now available.[28] (There would be an even larger number of such services on the market if cable were more competitive at the local distribution level.) Yet, of the 11,083 cable systems operating nationwide, only 1,152 systems or 10 percent of these systems carry more than 53 channels; over half the systems offer 30-53 channels; the remaining 35 percent offer fewer than 30 channels.[29]

27. My 1992 financial analysis of "overbuild" competition in cable sought to gauge the financial viability of competition in a typical U.S. cable market. I estimated expected rates of return for a new competitive cable system entering a market already served by one cable system, and possessing the following characteristics:

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[27] NCTA, Cable Television Developments 7-A (Mar. 1993).

[28] *Extra!*, Satellite Orbit Magazine, Mar. 1993.

[29] NCTA, Cable Television Developments 10-A (Mar. 1993).

50,000 homes; density (homes per mile of cable plant) of the U.S. average; revenue per subscriber of the U.S. average; subscribership of the U.S. average (with no increase attributable to competition); aerial to underground wiring ratio equal to the national average; revenue growth of 5 percent per year.[30] I assumed the firm's capital costs to be those listed as standard in a 1986 paper from the U.S. Department of Justice (the quality-adjusted cost of physical capital has been declining over time), operating costs to be 57.1 percent of revenues (the national average), and that the new entrant would garner a 50 percent market share but that no additional households would subscribe to cable (*i.e.*, the new firm would serve 50 percent of existing cable customers). Based upon this analysis, a new competitor could expect a return of 18 percent at average U.S. rate levels existing in 1991. Even allowing for a 20 percent fall in rates due to competition (and a corresponding increase in subscribership of 20 percent), a new entrant earns 16 percent. Since the model uses conservative assumptions,[31] and both numbers are above the cost of capital, this indicates that the typical cable market is financially capable of supporting two rival cable firms.

Direct Cable Competition is Financially Viable in Alexandria, Virginia

28. Alexandria, Virginia is particularly attractive from the standpoint of cable competition. The key variable to focus on in assessing financial viability is revenue per mile of plant: cable entrants must be able to anticipate

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[30] Thomas W. Hazlett, *Telco Entry Into Video*, paper presented to the Public Utility Research Conference, University of Florida (Apr. 1992).

[31] The cable industry, for instance, anticipates revenue growth above 5 percent; competition does increase subscribership, etc.

sufficient cash flows to sustain their fixed investments, largely constituted by laying the transport grid (*i.e.*, cables). Alexandria cable consumers now pay an average of $34.92 per month, well above the 1992 U.S. average of $32.12 (see Table 1). Moreover, the density of the market, 244 homes per mile, is *two and a half times* the U.S. average of 93. These two factors combine to make this particular market a likely candidate for head-to-head cable competition.

29. The 1990 Annual Report of Jones Intercable says virtually as much itself, in describing its Alexandria, Virginia market in glowing terms:

> Alexandria, Virginia * * * is a relatively stable, affluent community with excellent demographics, including a high rate of employment and one of the highest levels of population density in the Washington metropolitan area. The current population of Alexandria is approximately 112,000, with a median household income above the national average at approximately $42,600. More than 75 percent of Alexandria residents are employed in white-collar occupations, with 40 percent of those employed working in managerial and professional positions. Historically, these demographics have proven to be highly favorable for cable subscriptions and penetration rates.[32]

Telephone Companies are Important Potential Competitors in the Cable Market

30. Competition is economically possible in cable markets, but cable companies have proven very adept at blocking it. As noted above, favored cable strategies include aggressive and highly selective price discrimina-

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[32] Jones Intercable, 1990 Annual Report 6 (Dec. 31, 1990).

tion, exclusive contracts with programmers, and monopolization of the franchising process.[33]

31. In a market occupied by such powerful and aggressive incumbents, widespread competition must feature new entrants which begin with both technical sophistication and substantial financial resources. The telephone companies are the most likely such competitors. Certainly this has been the view of the cable incumbents, which have routinely targeted retention of the telco video programming ban as their top legislative priority.[34]

32. There are no technical barriers to head-to-head competition in the provision of video programming between telcos and cable providers. Cable does not utilize airwaves that are parcelled out by a regulatory body. Competing cables can be laid side by side. In fact, on a common carrier network such as C&P has indicated that it intends to build, competing video programs can be carried on the same wire.

33. Moreover, the 1978 Pole Attachment Act has fulfilled its purpose. U.S. cable markets have been wired by independent (non-telco) companies, including the Alexandria, Virginia market. Most utility poles and conduits are owned not by telephone companies but by other utilities,[35] and these utilities may and do provide cable tele-

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[33] A litany of abusive practices employed by cable incumbents, and their trade associations, to deter competitive entry was detailed by the largest such competitor, Telesat Cablevision in comments to the FCC. *See* Comments of Telesat Cablevision, Inc., *In re* Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Service, MM Dkt. No. 89-600 (F.C.C. Mar. 1, 1990).

[34] As a leading cable industry analyst, John Mansell, noted in 1988: "Needless to say, cable's number one priority is the continuance of the telco/cable cross ownership bar." Cable Television Franchising, Aug. 31, 1988, at 2.

[35] Stip. 23 ("Nationally, electric utilities own more poles than telephone companies."); in Alexandria, Virginia, C&P provides

vision service themselves,[36] in competition with cable companies. Municipalities, which control all public rights of way over and under the streets, are likewise permitted to operate their own cable systems,[37] and many do.[38] Nonetheless, independent cable companies have successfully deployed their own cables, even against this class of favorably positioned potential competitors.

Competition Against Cable Monopolists Would Lower Price, Increase Output, and Increase Diversity in Video Programming

34. There is today no plausible economic scenario according to which telco competition against incumbent cable monopolists would raise price or reduce the total amount of video programming offered to consumers. Competition reliably lowers prices for cable customers and thereby enlists greater numbers of subscribers; this constitutes an increase in diversity of programming as cable subscribers have access to many more video choices than non-cable customers.

35. In 1970, when the FCC first prohibited telephone companies from providing CATV service, cable was an infant industry. The FCC assumed (not unreasonably at the time) that by sheltering that industry from telco competition it could promote the development of a competing distribution notework.

2,744 poles and VEPCO, the local electric utility, provides 4,639 poles. Stip. 24.

[36] Stip. 26.

[37] *See* 47 U.S.C. 533(e)(1), 47 U.S.C. § 541(f). *See also Warner Cable Communications Inc.* v. *City of Niceville*, 911 F.2d 634, 637 (11th Cir. 1990) (No. 89-3273).

[38] As of 1992, 63 municipalities provide cable service through municipally owned cable systems. Stip. 25.

36. The new network has since developed, more successfully than the FCC might have imagined in 1970. Indeed, the cable industry has passed competitive maturity: it now monopolizes local video distribution.

37. As technology advances, the separation of telephone and video service becomes increasingly artificial. The marketplace surely reflects this, as cable companies are now actively seeking to provide voice telephone service in competition with existing telephone companies. For example, cable companies are rapidly building alliances with "competitive access providers" (CAPs), who run independent, usually fiber-optic, networks, typically through major urban centers, connecting businesses to each other and to long distance carriers. Overall, cable interests now control over 50 percent of CAP revenues.[39] At the same time, cable companies account for more of the experimental "personal communications service" (PCS) licenses issued by the FCC than all seven Regional Bell companies combined.[40] Jones Lightwave Ltd., an affiliate of Jones Intercable, has FCC experimental licenses for PCS trials in Alexandria, Virginia, and in Illinois, Florida,

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[39] The Yankee Group, CAP Market Update: Year of Transition 6 (Feb. 1992). For a non-exhaustive list of cable-CAP interests, see Stip. 49.

[40] Office of Engineering and Technology, FCC, PCS Experimental Applications by Filed Date (Mar. 1, 1993). *See also* Stip. 55. The nation's first coast-to-coast PCS phone call was placed through a cable television system in February 1992; many cable companies are using FCC experimental licenses to test PCS. The cable industry, according to its own publicity, "is well-suited to linking PCS radio-relay (cell) sites because cable passes 96 percent of U.S. homes." NCTA, Press Information, Cable Television Year in Review: 1992, at 3 (Nov. 24, 1992). *See also* NCTA, Cable Television: Bringing Fiber Optics to America 4 (Feb. 1992) ("The cable industry's vision anticipates that additional service capabilities will be developed under this design through interconnection with other communications technologies and services, such as Personal Communications Services * * *.").

and Colorado.[41] TCI, the nation's largest cable operator, predicts that cable systems will be capable of providing telephone service by the mid to late 1990s, using upgrades to cable networks that are already being deployed.[42]

38. With the current baseline of monopoly prevailing in the overwhelming number of cable markets, as well as in the specific market of Alexandria, Virginia, allowing a new entrant to compete cannot lessen consumer choice. This is true even if one assumes the worst: after some period of intense competition, a telco entrant eventually displaces the current monopolist. While highly unlikely (and remediable by several alternative means other than a blanket ban on video programming by telcos) even this worst case entails expanded consumer choice during the rivalrous stage, and no lessened choice in settling back to a monopolistic Square One. Because of the prevalence of sole supplier cable markets, we cannot do worse than we presently do.

39. The only relevant questions, then, are: How much will choice improve with new entry? And for how long?

40. The evidence on the first question is unmistakable: wherever and whenever competition does come about, consumer choices improve dramatically. First, prices fall, allowing more consumers to avail themselves of the video choices of the new technology. Second, competition supplies more video programming, more choice, more diversity. This is revealed in the substantially higher number

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[41] Stip. 56; FCC Experimental License Nos. 2429-EX-PL-92, 2430-EX-PL-92, 2431-EX-PL-92, 2432-EX-PL-92.

[42] Joanne Kelley, *Tele-Comm Unfurls $2.0 Billion Network Plan*, Reuters, Apr. 1, 1993. One cable company executive even claims that cable companies will soon offer basic cable service free to households that would otherwise decline to subscribe in order to promote the sale of telephone and other services. *Record CAB Attendance*, Communications Daily, Apr. 8, 1992, at 3 (quoting Amos Hostetter, Chairman of Continental Cablevision).

of program channels which competitive cable systems provide.

41. The cable industry's argument is that these beneficial effects will not endure in the long run. That is uncompelling in that some competitive period is preferred to none. Moreover, both economic theory and real world experience indicate that competition can and will endure.

42. The incumbent cable monopolists have invested in long-lived physical plant. Many are upgrading to fiber, which will last even longer. In economic jargon, these investments are already "sunk." Once the money has been spent, it is largely unsalvageable. Looking forward, then, the *future* cost of these facilities is close to zero. New entry by telcos cannot possibly deter competition by others when that long term commitment has already been made. The only realistic exit from the market, once significant costs have been sunk, is via merger—and that would take an explicit approval by the antitrust authorities.

43. Cable industry reaction to possible telephone company entry into video offers powerful testimony to the likely long-lived impact of telco-cable competition. Nationally, the cable industry is quickly upgrading its facilities, particularly with fiber optic investments, to prepare for the possibility of the telephone company competition they fear. The cable companies are thus signalling that they believe the entry of telcos into the market would result in more competition which justifies the sinking of durable capital. Indeed, since the filing of the lawsuit of which this affidavit is a part, Jones has had informal discussions with the City of Alexandria wherein it has offered to make additional investments in channel capacity in Alexandria if it receives a 20-25 year non-exclusive franchise.[48]

44. We cannot do any worse than monoply. There can be a debate over the magnitude of consumer im-

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[48] Stip. 89.

provement with new entry, but not of the direction. Prices will fall some amount, for some period. Choices will increase, by some amount for some time. There is simply no dispute: when one begins with monopoly, new entry can only increase the amount of consumer choice.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on this 29th day of April, 1993.

/s/ Thomas W. Hazlett
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Associate Professor
University of California
Davis, CA 95616-8512

Table 1. Cable Industry Trends.[1]

Year	House holds Subscribing to Cable (thousands)	Total Revenue ($ millions)	Revenue/ Subscriber/ Month ($)	Availability (Homes Passed/ Households) (%)	Penetration (Subscribers/ Homes Passed) (%)	US TV Households (%)
1960	750	50	5.56	N/A	N/A	1.4
1970	5,100	345	5.64	<10.0	N/A	6.6
1980	17,671	2,549	12.02	45.7	55.1	25.2
1984	37,290	7,800	17.43	72.0	56.5	43.7
1992	55,200	22,000	32.12	96.0	62.0	60.0

Table 2. Cable Network Growth.[2]

Year	Number of Networks
1970	0
1976	4
1984	49
1992	78

[1] The Kagan Cable TV Financial Databook 18 (June 1989); NCTA, Cable Television Developments 1-A, 2-A, 8-A (Mar. 1993); National Telecommunications and Information Administration, Dep't of Commerce, Video Program Distribution and Cable Television: Current Policy Issues and Recommendations 10 (June 1988); Florence Setzer and Jonathon Levy, FCC, OPP Working Paper 26, Broadcast Television in a Multichannel Marketplace 68 (June 1991); Paul Kagan Assoc., Cable TV Investor 5 (Feb. 12, 1993); Stip. 17.

[2] Stip. 9; NCTA, Cable Television Developments 7-A (Mar. 1993).

Table 3. Sales Price Data for U.S. Cable Systems, 1982-1992.[3]

Year	Number of Systems Sold	Total Subscribers	Price/Home Passed ($)	Price/ Subscriber ($)
1982	212	934,071	486	922
1984	295	3,023,144	520	948
1989	379	5,951,353	1,255	2,291
1990	105	531,207	1,277	2,049
1991	111	4,523,433	961	1,795
1992	97	1,876,754	1,023	1,768
1993 Jan.-Feb.	5	232,000	N/A	2,848

Table 4. Competitive Cable Systems Sales Prices, 1988-1992.[4]

Year	Sample Size (systems)	Sample Size ($ million sales)	Price/ Subscriber ($)	Price/ Subscriber ($) (U.S. Mean)*	Price vs. Monopoly (%)
1988	9	35.905	1,649	1,953	−18.5
1989	8	170.229	1,886	2,351	−19.7
1990	2	7.325	1,638	2,047	−20.0
1991	1	5.200	1,300	1,569	−17.1
1992	1	55.500	1,500	1,768	−15.1

[3] Paul Kagan Assoc., Cable TV Investor 13 (Jan. 25, 1993); Paul Kagan Assoc., Cable TV Investor 6 (Feb. 12, 1993).

[4] Paul Kagan Assoc., Cable TV Franchising News Roundup (June 28, 1991). Figures for 1992 are from Paul Kagan Assoc., Private Cable Investor 1 (Mar. 31, 1993).

* Prices per subscriber for U.S. average differ from those given by Kagan in Table 3, and may be due to different weighting of sales data (*e.g.*, by system rather than by subscriber size).

Table 5. Competitive vs. Monopolistic Cable Rates from Current FCC Data.[5]

	Sample Size (systems)	Mean Basic Price/Month ($)	Mean Basic Channels (#)	Price/ Channel ($)
Monopoly	296	22.49	34.75	0.65
Competitive	46	19.02	46.59	0.41

Table 6. Competitive vs. Monopolistic Cable Systems Summary Statistics from 1992 Kagan Data.[6]

	Sample Size (Subscribers) (millions)	Mean Revenue/ Subscriber/ Month ($)	Mean Basic Monthly Rate ($)	Mean Basic Channels (#)	Monthly Price/ Channel ($)
Monopoly	54.89	32.12	19.08	35 *	.55
Competitive (103 systems)	1.13	25.08	17.49	40	.44
Price/Quality Difference vs. Monopoly		−21.9%	−8.3%	+14.3%	+19.8%

[5] Federal Communications Commission, Release of Data from Cable TV System Operators Rate Structure Questionnaire) (Feb. 24, 1993); Communications Daily, Mar. 4, 1993, at 2-3. As defined here, "basic cable" includes both Tier 1 (generally known as "limited basic") and Tier 2 (what most consumers call "basic").

[6] Paul Kagan Assoc., Cable TV Franchising News Roundup (June 28, 1991); Paul Kagan Assoc., Cable TV Franchising 4 (Apr. 30, 1992); NCTA, Cable Television Developments 1-A (Mar. 1993).

* See Table 5.

Table 7. Monthly Cable Rates in Competitive vs. Non-Competitive Areas ($).[7]

		ATC		Cablevision Industries	
Service	Telesat	Competitive	Non-Competitive	Competitive	Non-competitive
Basic ($)	17.95	13.95	20.70	11.95	18.95
Additional Outlets ($)	0.00	0.00	4.95	0.00	3.50
Remote Control ($)	0.00	0.99	4.00	0.00	4.00
Pay Channel ($)	9.95	8.95	11.60	7.45	10.00
Installation ($)	0.00	0.00	49.95	0.00	50.00

[7] Paul Kagan Assoc., Cable TV Franchising News Roundup 3 (Apr. 30, 1992).

* One-time connection charge.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

[Caption Omitted in Printing]

JOINT STIPULATIONS OF FACT

For purposes, and solely for purposes, of this litigation, the parties, through undersigned counsel, hereby stipulate to the following facts:

A. *Stipulations Proffered By Plaintiffs* [1]

1. The Chesapeake and Potomac Telephone Company of Virginia (C&P) is a wholly owned subsidiary of Bell Atlantic Corporation. Bell Atlantic is privately owned and has over a million shareholders.

2. C&P is one of the telephone companies in the United States that is subject to common carrier regulation under title II of the Communications Act of 1934 and also state laws.

3. Fiber optic technology is capable of providing telephone service and transmitting video programming on an integrated basis directly to subscribers.

4. In 1984, no telephone company provided transport of video programming to subscribers over its telephone lines.

5. C&P carries the video programming of third parties at the Cascades, a development in Loudoun County,

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[1] Although the parties proffering each series of stipulations have been identified, the parties acknowledge that each stipulation herein was subject to negotiation and modification by all parties prior to agreement.

pursuant to the FCC's *Order and Authorization*, File No. W-P-C-6649 (Jan. 11, 1991). C&P carries the video programming of third parties in Northern Virginia pursuant to the FCC's *Order and Authorization*, File No. W-P-C-6834 (Mar. 25, 1993).

6. As an information service provider, C&P provides its own voice and data messages, and messages of its affiliates, to the public. These services include, for example, time of day and weather services, Enhanced 911 service, and home shopping services.

7. Bell Atlantic Video Services Company (BVS) is an affiliate of C&P, incorporated in Virginia on September 24, 1992, for the purpose of providing video programming to the public.

8. In 1991-1992, 43 percent of viewing time in households that subscribe to cable was devoted to basic cable program networks and pay cable services.

9. In 1976, there were four national cable video networks in existence; in 1984, there were 49 national cable video networks; in 1992, there were 78 national cable video networks. In 1984, expenditures by cable systems to obtain programming were approximately $1.74 billion; in 1992, cable system expenditures to obtain programming were approximately $3.8 billion.

10. According to FCC, Office of Plans and Policies, *Broadcast Television in a Multichannel Marketplace*, OPP Working Paper No. 26 at 19 (June 1990), the average U.S. television household watches television approximately seven hours a day.

11. According to *The Veronis, Suhler & Associates Communications Industry Forecast* at 12 (1992), in 1991, the average U.S. resident spent 1,515 hours watching television, 1,115 hours listening to radio programming, 43 hours watching prerecorded videos at home, 9 hours watching theater movies, and 169 hours reading daily newspapers.

12. Statistics compiled by the Census Bureau show that 98% of U.S. households had a television set as of 1991.

13. Statistics compiled by the FCC and the Census Bureau show that 93% of U.S. households subscribed to telephone service as of 1991.

14. According to Sara Fritz & Dwight Morris, *Handbook of Campaign Spending: Money in the 1990 Congressional Races* 53, 54 (Congressional Quarterly 1992), in the 1990 election, 29 percent of the money spent by Congressional candidates went for radio and television advertising and media consultants. On average, radio and television advertising accounted for 35 percent of the money spent by Senate candidates and 23 percent of the money spent by House candidates. Congressional candidates spent about $119 million on broadcast advertising in the 1990 election.

15. NCTA and several of its members filed actions claiming that Sections 4 and 5 of the Cable Television Consumer Protection and Competition Act of 1992 violate their First Amendment rights and that Section 6 should be set aside as inseverable from Sections 4 and 5. *See National Cable Television Association, Inc. v. United States*, Civil Action No. 92-2495 (D.D.C.) and consolidated actions, Nos. 92-2247, 92-2292, 92-2494, 92-2558. One of NCTA's members has filed an action claiming that Sections 3, 7(b)(4)(B) and (C), 9, 10(d), 11, 15, 19, 24, and 25 of the Cable Television Consumer Protection and Competition Act of 1992, and Sections 611 and 612 of the Cable Communications Policy Act of 1984 violate its First Amendment rights. *Time Warner Entertainment Corp., L.P. v. FCC*, Civil Action No. 92-2494 (D.D.C.).

16. In 1986, Jones's price for basic cable service in Alexandria, which included 27 channels of programming, was $11.00 per month.

17. In 1970, according to the FCC in *Telephone Company-Cable Television Cross-Ownership Rules*, 7

FCC Rcd 5781, 5848 (1992), and the Census Bureau, *Statistical Abstract of the United States 1992* at 551, Table 884 (112th ed. 1992), cable passed less than 10% of all television households. In 1976, cable passed approximately 33% of all television households. In 1984, cable passed approximately 72% of all television households. Cable now passes approximately 96% of television households, and approximately 60% of television households subscribe.

18. In Alexandria, Jones Intercable, which is presently the sole provider of cable service in Alexandria, passes over 90% of all television households, and 57% subscribe.

19. Currently, the supply of available video programming exceeds the available channel capacity of almost all cable systems.

20. Cable systems presently have an average capacity of about 40 channels. In 1992, 88% of cable systems had fewer than 54 channels; however, approximately 35 percent of all subscribers were served by systems with 54 or more channels.

21. In Alexandria, Jones Intercable presently has a capacity of 51 channels.

22. In October 1979, C&P entered into an agreement with a predecessor to Jones which provided for the placement of cable facilities on C&P poles and in C&P conduit in Alexandria. This agreement was assigned to Jones when it acquired the cable system in 1986. The Alexandria cable system Jones acquired had been deployed sometime prior to Jones's acquisition; C&P has not provided any additional pole attachments for this system since 1984; and, since Jones acquired the system in 1986, Jones has not asked C&P to provide any new pole attachments.

23. Nationally, electric utilities have more poles than do telephone companies.

24. In Alexandria, C&P currently provides 2744 pole attachments to Jones and VEPCO, the local electric utility, provides 4639 pole attachments.

25. According to the Public Power Directory, there are 63 municipally-owned cable television systems in the U.S. Of these communities, 38 also have a municipally-owned electric system.

26. Florida Power & Light Co. currently operates a cable system in the same locality where it provides electric utility service.

27. According to the Census Bureau, annual cable operator revenues in 1970 were $345 million. In 1976, annual cable operator revenues from subscriber services including advertising were approximately $933 million. In 1984, annual cable operator revenues were approximately $7.8 billion. In 1992, annual cable operator revenues were approximately $21.5 billion.

28. Of the approximately 10,000 communities served by cable, as of 1991, 53 communities had more than one competing cable system in the same locality.

29. Some cable systems serving individual communities are owned by national or regional chains, known as multiple system operators (MSOs). The five largest MSOs combined serve 41.4% of all cable subscribers.

30. According to the Newspaper Association of America, *Facts about Newspapers '92* at 26 (1992): Some newspapers serving individual communities are also owned by national or regional chains. Daily newspapers are published in 1,513 cities. One hundred and thirty-three newspaper groups own 1,213 daily newspapers, or about 75% of all U.S. daily newspapers. Eighty-two groups own five or fewer daily newspapers; 51 groups own six or more daily newspapers. There is competition between daily newspapers under separate ownership in 37 cities. In 19 of these 37 cases, the competitors are published under joint operating agreements under an exemption from the antitrust laws.

31. Some of the companies that operate multiple cable systems and their 1991 revenues from all sources are: Tele-Communications, Inc. which serves 9.6 million cable subscribers and had total revenues of $3.8 billion; Time Warner which serves 6.8 million cable subscribers and had total revenues of $12 billion; Continental Cablevision which serves 2.8 million cable subscribers and had total revenues of $570 million; Comcast which serves 2.8 million cable subscribers and had total revenues of $720 million; Cablevision Systems which serves 2 million subscribers and had total revenues of $603 million; and Cox which serves 1.7 million subscribers and had total revenues of $2.3 billion.

32. Including its affiliates, Jones Intercable is the eighth largest multiple cable system operator in the U.S. with 1.5 million cable subscribers. Jones believes that it is the world's largest cable management company. Cable management companies operate cable systems they do not own.

33. Jones Intercable currently provides cable service in competition with another cable company in Anne Arundel County, Maryland.

34. As of April 1993, Jones charges $24.65 per month in Alexandria for a 44-channel package of programming. In Anne Arundel County, Jones charges $21.20 for either a 53-channel package of programming in areas where its system has been upgraded, or the same amount for a 43-channel package where its system has not yet been upgraded.

35. Cable subscribership in Alexandria is approximately 57%. Cable subscribership in Anne Arundel County is over 70%.

36. According to an April 1, 1993 FCC News Release, the price per channel of programming offered by competing cable systems is lower than the price where cable systems do not compete.

37. There are no absolute physical barriers to the construction of competing multichannel cable services at-

tributable to the physical scarcity of the electromagnetic spectrum. This is true generally and in Alexandria.

38. In delivering video programming of third parties in Northern Virginia pursuant to the FCC's *Order and Authorization*, File No. W-P-C-6834 (Mar. 25, 1993), C&P does not use the electromagnetic spectrum.

39. Both before and after this case was filed, Jones Intercable has had informal discussions with the City of Alexandria and has offered to make additional investments in channel capacity in Alexandria if it received a 20-25 year nonexclusive franchise. These discussions began before this case was filed.

40. Currently, both coaxial cable and optical fiber are used for wireline transmission of cable system video signals. Previously, only coaxial cable was used for this purpose. In general, multiple lines of coaxial cable or fiber optics can be placed next to each other without mutual interference to video signals they carry. This means competing cable transmission systems can exist side-by-side without such interference.

41. Originally, cable systems were primarily designed to provide one-way video signals. The newest cable system architecture is capable of supporting two-way telephone and data services.

42. According to the NCTA, looking solely at subscriber plant (i.e., not counting connections between exchanges or adjacent cities), in 1991 the regional Bell telephone companies installed approximately 8685 miles of fiber optic cable, while cable companies installed approximately 6408 miles of fiber optic cable. In a speech at the 1992 NCTA annual convention, the President of the NCTA stated that "Cable is now installing optical fiber at an annual rate that is 74 percent of what the RBOCs are doing. And we're gaining fast."

43. In a speech at the 1992 NCTA annual convention, the President of the NCTA stated that "[t]he biggest telecommunications story of the decade may turn out to be

not telcos' creating broadband networks, but cable technology and architecture proving to be the most efficient means of delivering the next generation of communications services."

44. In September, 1992, Comcast, the fifth largest multiple system operator and the current provider of cable service and one of the two cellular radio services in Philadelphia, placed an international telephone call from Philadelphia to London without the use of local wireline exchange services at the originating end in the United States.

45. Some cable companies in the U.K. are providing integrated video programming and telephone service in direct competition with the telephone company in the U.K., British Telecom.

46. In 1990, approximately 30% of the operating revenue of U.S. local exchange carriers came from the provision of "access services," *i.e.*, services that local telephone companies provide to long distance companies to connect local subscribers with the facilities of the long distance carriers at the originating and terminating ends of long distance calls.

47. So-called Competitive Access Providers ("CAPs") have entered the interstate access market in recent years, serving the needs of large, communications-intensive businesses, predominantly in metropolitan centers, that generate high volumes of long-distance telephone traffic. CAPs generally deploy fiber-optic facilities or, in some cases, microwave systems. It is estimated that the CAPs have invested hundreds of millions of dollars in their facilities.

48. Metropolitan Fiber Services, a CAP, competes with C&P in portions of Northern Virginia for the provision of interstate access services to the types of customers referred to in Stipulation 47.

49. Several members of NCTA have purchased interests in companies that provide interstate access services

in competition with local telephone companies. These include, but are not limited to:

a. TCI and Cox own Teleport, a CAP that provides service in New York, New Jersey, and Chicago, among other places. Comcast and Continental Cablevision have each agreed to purchase 20% equity interests in Teleport subject to regulatory approval.

b. Comcast owns 54% of Eastern Telelogic, a CAP that provides service in Philadelphia.

c. TCI has applied for authority to acquire Penn Access Corporation, a CAP that provides service in Pittsburgh.

d. Affiliates of Jones Intercable presently provide CAP services in two U.S. cities.

50. Southwestern Bell, which provides telephone service in the southwestern United States, has announced plans to purchase two cable systems in the Washington metropolitan area.

51. Southwestern Bell currently provides cellular radio service in Northern Virginia and the Washington-Baltimore metropolitan area.

52. The FCC licenses wireless telecommunications services. In the 1980's, the FCC licensed cellular mobile telephone services which overcame the need for wired connections between a subscriber and a telephone company switching center. The FCC licensed radio spectrum to two competing providers in each cellular service area. By regulation, one of the two competing providers initially was the local wireline telephone exchange carrier.

53. There are now 11 million subscribers in the United States to cellular service and their number continues to grow. In 1992, the number of cellular subscribers grew by over 40 percent. The cellular industry is now converting to digital technologies that will expand the carrying capacity of their systems several-fold.

54. The FCC has begun a series of proceedings to license additional wireless services. *In the Matter of Amendment of the Commission's Rules To Establish New Personal Communications Services*, 7 FCC Rcd 5676 (1992); *In the Matter of Amendment of the Commission's Rules To Establish New Personal Communications Services*, 7 FCC Rcd 7794 (1992).

55. The FCC has granted 203 experimental licenses for personal communications services ("PCS") as defined *in Notice of Proposed Rulemaking, Redevelopment of Spectrum to Encourage Innovation in the Use of New Telecommunications Technologies*, CC Dkt. No. 92-9 (FCC Feb. 7, 1992). Thirty five of these have been granted to cable companies.

56. Jones Lightwave Ltd. is an affiliate of Jones Intercable. Jones Lightwave Ltd. has FCC experimental licenses for PCS trials in Alexandria, Virginia, and in Illinois, Florida, and Colorado. *Experimental License Nos. 2429-EX-PL-92, 2430-EX-PL-92, 2431-EX-PL-92, 2432-EX-PL-92.*

57. The FCC has tentatively decided to grant a pioneer's preference in *In the Matter of Amendment of the Commission's Rules To Establish New Personal Communications Services*, 7 FCC Rcd 7794 (1992) to, among others, a cable company.

58. A good cause waiver application that was filed in April 1992 by the telephone company serving Bentleyville, Pennsylvania to provide video programming in that community, *Petition for Waiver and Section 214 Application, In the Matter of The Bentleyville Telephone Co.*, File No. W-P-C-6817 (Apr. 29, 1992), is pending. Helicon, the incumbent cable operator in Bentleyville, filed an opposition on June 11, 1992.

59. An April 1990 good cause waiver application, opposed by the NCTA, to provide video programming over fiber optics by the telephone company serving Ranchos Las Flores, California, *Public Notice: Contel of*

California, Inc. Section 214 Application and Request for Waiver of the Telco/Cable Cross-Ownership Rules, File No. W-P-C-6575 (Mar. 12, 1990), is pending.

60. In February, 1987, GTE California, Inc., the telephone company serving Cerritos, California, applied to the FCC for authority to construct cable facilities in Cerritos. That application was granted in July 1989. On the NCTA's petition for review, the D.C. Circuit remanded the matter to the Commission for further proceedings in September, 1990. *National Cable Television Ass'n, Inc. v. FCC,* 914 F.2d 285 (D.C. Cir. 1990). Thereupon, the FCC engaged in an effort to facilitate a voluntary settlement among the parties. When no settlement had been achieved by June, 1992, the Commission requested comments as to what further action it should take, and no order has issued.

61. Approximately 34 million people live in the states where Bell Atlantic's local exchange telephone companies provide telephone service.

62. Some cable companies charge additional fees for connecting additional television sets and for additional set-top converters that are sometimes needed to decode the cable signal.

63. Since 1978, to the best of the parties' current knowledge, C&P has never terminated an agreement for pole attachments or conduit with a company that was providing cable service to customers.

64. Since 1978, to the best of the parties' current knowledge, there has never been a complaint to the FCC regarding C&P's conduit rates.

65. High-bit-rate digital subscriber line technology (HDSL), which is a two-way version of the technology used for asymmetric digital subscriber line (ADSL), is used in commercial applications for data transmission.

66. Broadcasters and cable operators do not currently provide high-definition television.

67. BVS is assertedly still in the process of arranging to obtain from suppliers the video programming that BVS will provide directly to subscribers, and to obtain the right to retransmit such programming.

68. BVS is assertedly still in the process of developing the programming that it would seek to have originated on its behalf.

Stipulations Proffered by the Government Defendants [2]

69. As used herein, the terms "affiliate" and "affiliated" shall have the same meaning as in 47 U.S.C. §§ 522 (1), 533(b). Plaintiffs Chesapeake and Potomac Telephone Company of Virginia ("C&P") and Bell Atlantic Video Services Company ("BVS") are affiliated with each other and with a number of local wireline telephone exchange carriers by virtue of their common ownership by Bell Atlantic Corporation ("Bell Atlantic"). These affiliates provide local wireline telephone exchange service in the District of Columbia, Delaware, nearly all of Maryland, and portions of Virginia, West Virginia, Pennsylvania and New Jersey, as indicated below:

(a) The Chesapeake and Potomac Telephone Company provides local wireline telephone exchange and exchange access service in the District of Columbia.

(b) The Chesapeake and Potomac Telephone Company of Maryland provides local wireline telephone exchange and exchange access service in nearly all of Maryland.

(c) The Chesapeake and Potomac Telephone Company of Virginia provides local wireline telephone exchange and exchange access service in portions of

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[2] Although the parties proffering each series of stipulations have been identified, the parties acknowledge that each stipulation herein was subject to negotiation and modification by all parties prior to agreement.

Virginia, including all of the City of Alexandria, Virginia ("Alexandria").

(d) The Chesapeake and Potomac Telephone Company of West Virginia provides local wireline telephone exchange and exchange access service in portions of West Virginia.

(e) The Diamond State Telephone Company provides local wireline telephone exchange and exchange access service in Delaware.

(f) New Jersey Bell Telephone Company provides local wireline telephone exchange and exchange access service in portions of New Jersey.

(g) The Bell Telephone Company of Pennsylvania provides local wireline telephone exchange and exchange access service in portions of Pennsylvania.

Other than Telecom Corporation of New Zealand, a Bell Atlantic affiliate that provides telephone service in New Zealand, no entity with which C&P, BVS or Bell Atlantic is affiliated provides local wireline telephone exchange service anywhere outside the above-described territory.

70. C&P currently provides, has sought authority to provide, or has announced plans to provide, channels of communication to the following unaffiliated entities, in the following places, for the purpose of providing video programming directly to subscribers:

(a) C&P provides channels of communication to Cablevision of Loudoun in the Cascades development in Loudoun County, Virginia, pursuant to, and subject to the conditions of, the FCC's *Order and Authorization*, File No. W-P-C-6649 (Jan. 11, 1991).

(b) C&P provides channels of communication to multiple unaffiliated video programmers in portions

of northern Virginia, pursuant to, and subject to the conditions of, the FCC's *Order and Authorization*, File No. W-P-C-6834 (Mar. 25, 1993).

71. C&P currently provides pole line attachments to 69 unaffiliated cable television operators in its territory, for the purpose of providing cable service directly to their subscribers.

72. C&P provides conduit to approximately 14 unaffiliated cable television operators in its telephone service area, for the purpose of providing cable service directly to subscribers.

73. Bell Atlantic's local telephone subsidiaries have provided, currently provide, have sought authority to provide, or have announced plans to provide, channels of communication to the following unaffiliated entities, in the following places:

(a) The Chesapeake and Potomac Telephone Company provides channels of communication in the District of Columbia to District Cablevision, Inc., for the purpose of providing cable service directly to subscribers.

(b) The Bell Telephone Company of Pennsylvania previously provided channels of communication in Perryopolis, Pennsylvania to the Helicon Group, Ltd. for the purpose of providing cable service directly to subscribers.

(c) New Jersey Bell Telephone Company has sought authority to provide video dialtone service in Florham Park Borough, Madison Borough and Chatham Borough, New Jersey to multiple unaffiliated video programmers, including Sammons Communications of New Jersey, Inc.

(d) New Jersey Bell Telephone Company has sought authority to provide video dialtone service in Dover Township, Ocean County, New Jersey to

multiple unaffiliated video programmers, including FurtureVision of America Corporation.

74. In November 1992, New Jersey Bell, a subsidiary of Bell Atlantic, entered into a 10-year agreement with FutureVision of America Corp. under which FutureVision agreed to use tariffed common carrier video transport service provided over New Jersey Bell's telephone network to provide video programming within New Jersey Bell's telephone service area.

75. On December 22, 1992, the New Jersey Board of Regulatory Commissioners announced its approval of a regulatory reform plan for New Jersey Bell, a subsidiary of Bell Atlantic, including endorsement of New Jersey Bell's plan to accelerate the deployment of broadband technology to every home and office in the state by 2010. Board approval for this investment was not required. During the proceedings before the Board in 1992, New Jersey Bell estimated that its total network capital investment through the end of the century would be approximately $5.3 billion.

76. There have been discussions between Bell Atlantic and one or more video programmers regarding the provision of video programming services outside the areas where Bell Atlantic's telephone companies provide telephone service.

77. As of 1992, the following Bell Atlantic local telephone subsidiaries provided pole line attachments to the following numbers of unaffiliated cable system operators in their telephone service areas:

(a) New Jersey Bell Telephone Company provides pole attachments to approximately 66 unaffiliated cable operators in New Jersey.

(b) The Chesapeake and Potomac Telephone Company provides pole attachments for video transport facilities that C&P holds legal title to, and that are

leased to an unaffiliated cable operator in the District of Columbia.

(c) The Chesapeake and Potomac Telephone Company of Maryland provides pole attachments to approximately 36 unaffiliated cable operators in Maryland.

(d) The Chesapeake and Potomac Telephone Company of West Virginia provides pole attachments to approximately 87 unaffiliated cable operators in West Virginia.

(e) The Diamond State Telephone Company provides pole attachments to approximately 7 unaffiliated cable operators in Delaware.

(f) The Bell Telephone Company of Pennsylvania provides pole attachments to approximately 148 unaffiliated cable operators in Pennsylvania.

78. As of 1992, the following Bell Atlantic local telephone subsidiaries provided conduit to the following number of unaffiliated cable system operators in their telephone service areas:

(a) New Jersey Bell Telephone Company provides conduit to approximately 34 unaffiliated cable operators in New Jersey.

(b) The Chesapeake and Potomac Telephone Company provides conduit for video transport facilities that C&P holds legal title to, and that are leased to an unaffiliated cable operator in the District of Columbia.

(c) The Chesapeake and Potomac Telephone Company of Maryland provides conduit to approximately 8 unaffiliated cable operators in Maryland.

(d) The Chesapeake and Potomac Telephone Company of West Virginia provides conduit to approximately 7 unaffiliated cable operators in West Virginia.

(e) The Diamond State Telephone Company provides conduit to two unaffiliated cable operators in Delaware.

(f) The Bell Telephone Company of Pennsylvania provides conduit to approximately 11 unaffiliated cable operators in Pennsylvania.

79. C&P represents that the provisions contained in the License Agreement For Pole Attachments And/Or Conduit Occupancy dated September 1, 1992 between C&P and Century Mountain Corp. are typical of C&P's agreements with cable operators for lease of pole attachments and conduit space.

80. Pacific Telesis Corp. either directly or through entities with which it is affiliated (including its wholly owned subsidiary, Pacific Bell) provides local telephone service only in portions of Nevada and California. Pacific Telesis has an option to buy a majority interest in Prime Cable of Chicago, Inc., which provides cable service in Chicago, Illinois.

81. Southwestern Bell Corp. ("Southwestern"), either directly or through entities with which it is affiliated, provides local telephone service in Arkansas, Kansas, Missouri, Oklahoma and Texas. Southwestern has an agreement with Hauser Communications, Inc. to purchase and operate Montgomery County Cablevision (which provides cable service in Montgomery County, Maryland) and Arlington Cable Partners (which provides cable service in Arlington County, Virginia).

82. C-TEC owns Commonwealth Telephone Company and C-TEC Cable Systems. As of June 30, 1992, C-TEC Cable Systems provided cable service to subscribers through 76 cable systems in four states. C-TEC Cable Systems provides cable television service outside the areas where Commonwealth Telephone Company provides telephone service.

83. As of March 15, 1989, and prior to its sale, Centel Corp. held 82 percent of the stock of Centel Cable TV Co. As of 1989, Centel Cable TV Co. provided cable television service to subscribers through 132 cable systems in six states outside Centel Corp.'s telephone service area. In 1989, Centel exited the cable business by selling its cable systems.

84. According to a February 1993 US West press release, US West is taking "a major step toward building a new combined video and voice communications network" and has requested bids for the components of a "broadband telecommunications network capable of providing video, data and voice communication service." According to US West, the network will have "the ability to offer traditional telephone service—basic dial tone, caller ID, voice messaging, etc.—as well as the traditional services offered by cable TV companies." The first technical trials of this upgraded network will begin November/December 1993 and regular commercial use will begin in late 1994.

85. In January 1993, Pacific Telesis announced a five-year plan to spend more than $1 billion to replace all of its remaining analog switches in California with state-of-the-art digital switches.

86. In July 1992, Ameritech announced plans to triple the amount of fiber optic facilities in its subsidiary telephone company networks over the next three years, including plans of Michigan Bell to invest $2 billion during the next four years in the deployment of advanced facilities, including fiber optic cable.

87. If C&P now were to enhance its telephone network in Alexandria to render it capable of providing video programming directly to subscribers, it maintains that it would replace its existing copper loop with a fiber optic system using coaxial cable drops. C&P also maintains that at the time it actually would begin enhancement of its network, it would use the optimal technology avail-

able, which, other than fiber optics, might include asymmetric digital subscriber line ("ADSL") technology.

88. C&P estimates that the present cost of replacing its existing copper loop facilities in Alexandria with the fiber optic facilities necessary to provide video programming and other services to subscribers in Alexandria is $50-100 million.

89. ADSL technology, which was developed in approximately 1991, has never been used on a commercial basis to provide video programming directly to subscribers.

90. As far as the parties are aware, ADSL's capability to provide video programming directly to subscribers has never been tested under real-world conditions over a telephone network, prior to C&P's test being conducted in Northern Virginia pursuant to the FCC's *Order and Authorization,* File No. W-P-C-6834 (Mar. 25, 1993).

91. Currently, ADSL technology requires that an entire program be digitally coded and compressed before it can be made available for viewing by subscribers.

92. Digital compression and encoding equipment is used to prepare video programming for transmission over ADSL-equipped copper loops. Currently, C&P has no equipment capable of compressing and encoding video programming on a real-time basis. This means, for example, that using ADSL, C&P currently could not provide live sports or news programs to subscribers at the same time such programs would be available to viewers of broadcast or non-ADSL dependent cable television.

93. Currently, one telephone line using ADSL technology can deliver only one video signal into the home at a time. If more than one television set is hooked up to a single ADSL-equipped telephone line, all sets will be limited to showing the same program. Additional ADSL equipped telephone lines to the home are required in order to watch different programs on different sets at the same time. With conventional cable technology, a single coaxial cable carries multiple channels of programming

into the home; multiple television sets can show different programs.

94. ADSL technology is not currently capable of providing high-definition television.

95. C&P may or may not charge a fee to subscribers for installation of commercial ADSL service.

96. ADSL transmission technology, the specifications for which were developed by Bellcore, is available to Regional Bell Operating Companies other than Bell Atlantic.

97. If C&P's telephone network is enhanced as referred to in the Complaint, ¶ 28, plaintiffs assertedly plan to transmit digital voice, data and video signals over the network on an integrated basis. Thus, in addition to the local telephone exchange and exchange access service now already provided, plaintiffs assertedly would use the network, as enhanced, for the transmission to consumers of video programming provided by BVS, the video programming of unaffiliated program providers, and any non-video information services of C&P, BVS and other providers.

98. Coupled with these transmission services, plaintiffs assertedly would provide a means through which consumers would have access to the video and non-video providers on the network and choose the video programming (or other information services) they wish to use at any given time. Plaintiffs assertedly would offer these services to BVS, unaffiliated video programmers and other information service providers on a tariffed, non-discriminatory, basis.

99. Plaintiffs also assertedly plan to provide consumers access through the network to enhanced and non-common carrier services. Enhanced services, which could be offered either by plaintiffs or other service providers on the network, might offer consumers advanced program search and preview capabilities, and other functions.

100. If plaintiffs rely on technology other than, or in addition to, fiber optics (e.g., ADSL, encrypted broadcast transmission, local or multichannel multipoint distribution system, or direct broadcast satellite transmission), to provide video programming to subscribers, they may or may not provide it in the manner described in paragraphs 97-99, above.

101. C&P's telephone network currently has no capability of providing video programming directly to subscribers in its telephone service area without the enhancements referred to in Complaint, ¶ 28, with the exception of:

> (a) the service now being provided in the Cascades Development of Loudoun County, Virginia pursuant to, and subject to the conditions of, the FCC's *Order and Authorization*, File No. W-P-C-6649 (Jan. 11, 1991); and
>
> (b) the service now being provided in Northern Virginia pursuant to, and subject to the conditions of, the FCC's *Order and Authorization*, File No. W-P-C-6834 (Mar. 25, 1993).

102. As of this time, plaintiffs have neither received nor applied for, nor prepared an application for, authority from the FCC, pursuant to section 214 of the Communications Act of 1934, to make the enhancements (as referred to in the Complaint, ¶ 28) that are necessary to render C&P's telephone network capable of delivering video programming directly to subscribers on a commercial basis, except as noted in paragraph 101(a), above.

103. As of this time, plaintiffs have neither received nor applied for, nor prepared an application for, authorization from the FCC to provide video programming directly to subscribers in Alexandria via (i) encrypted broadcast transmission, (ii) local multipoint distribution systems, (iii) multichannel multipoint distribution systems, or (iv) direct broadcast satellite. Plaintiffs have

no agreements with operators of such systems to lease excess spectrum capacity that could be used to provide video programming to subscribers in C&P's telephone service area.

104. C&P, BVS and Bell Atlantic do not, either individually or collectively, hold or have a pending application or bid for a local cable television franchise in Alexandria, Virginia or elsewhere in C&P's telephone service area.

105. Bell Atlantic is seeking, on behalf of itself and its local telephone subsidiaries (such as C&P), a waiver of the terms of the consent decree in *United States v. Western Elec. Co.*, No. 82-0192 (HHG) (D.D.C.) (also known as the "Modification of Final Judgment," or "MFJ") so as to permit Bell Atlantic and its subsidiaries to transport video programming without regard to local access and transport area ("LATA") boundaries.

106. The Washington, D.C. Metropolitan LATA, in which Alexandria is located, encompasses the District of Columbia and portions of Virginia and Maryland.

107. As of this time, plaintiffs have not entered into any written contracts to take delivery within the Washington, D.C. Metropolitan LATA of programming to be provided directly to subscribers that originates outside the Washington, D.C. Metropolitan LATA and that would have to be delivered by satellite.

108. Examples of video programming that would originate inside the D.C. Metropolitan LATA include:

—programming stored within the LATA

—local broadcast programming

—local origination programming

—local public, educational or governmental programming

109. Examples of programming that would originate outside the D.C. Metropolitan LATA include:

—distant broadcast signals such as WWOR or TBS;

—satellite cable programming such as ESPN or CNN, and pay cable channels such as Home Box Office or Cinemax.

110. Currently, BVS is the only video programmer that has committed to use the video transport services to be offered commercially over C&P's telephone network in Alexandria. No other programmer has contracted or otherwise committed to use C&P's network in Alexandria.

111. C&P and BVS have not entered into any written contract for the provision of video transport services by C&P to BVS. As of this time, C&P has not prepared the schedule of tariffs under which it would provide video transport services to BVS or others.

112. BVS currently owns no video programming.

113. BVS can obtain video programming for distribution on C&P's network, or elsewhere, only by (i) acquiring, or acquiring the right to restransmit, programming owned or controlled by others, (ii) by contracting with persons capable of originating video programming on BVS' behalf, or (iii) producing original video programming on its own.

114. As of this time, no supplier of video programming has entered into a written contract to provide to BVS the video programming that BVS will provide directly to subscribers or to grant BVS the right to retransmit such programming.

115. As of this time, no one capable of producing original video programming on BVS' behalf has entered into a written contract to do so.

116. As of this time, BVS itself has not produced any video programming that it intends to provide to subscribers.

117. It is possible that plaintiffs might have a cognizable ownership interest in programmers, other than BVS,

who would provide video programming to subscribers in Alexandria over C&P's network.

118. C&P would not exercise direct or indirect editorial control over, or in any way participate in the selection or packaging of, the video programming planned to be provided over its network, with the exception of:

(a) video programming supplied by BVS, over which BVS will exercise editorial control, and which BVS will select and package;

(b) possibly, video programming provided by video programmers in which C&P, BVS or Bell Atlantic might have an ownership interest;

(c) introductory menus, gateways or other such information content that C&P, BVS or Bell Atlantic might provide;

(d) the possible exclusion of pornography or other offensive material to the extent permitted under common carrier regulation.

119. For the trial service being provided in Northern Virginia (*see* paragraph 101(b), above), C&P is using a video storage computer with a capacity to hold 30 feature-length films. At this time neither plaintiffs nor Bell Atlantic have acquired the larger video storage computer that they intend to use to provide video programming on a commercial basis.

120. If C&P's telephone network were used to provide video programming from BVS directly to subscribers, BVS' programming would be transmitted to C&P's network, and from there as far as the customer premises, via equipment and facilities to be owned by C&P. At this time, C&P has not obtained all the facilities and equipment that will be used as part of the enhancements referred to in the Complaint, ¶ 28.

121. BVS was incorporated on September 24, 1992.

122. C&P assertedly made its firm decision to pursue

the possibility of providing video programming directly to subscribers in C&P's telephone service area on September 14, 1992.

123. Until the July 25, 1991 decision in *United States v. Western Elec. Co.*, 767 F. Supp. 308 (D.D.C. 1991), and the October 7, 1991 decision of the D.C. Circuit to lift the district court's stay of its July 25 order, the MFJ, §§ II(D)(1), IV(J), prevented the Regional Bell Operating Companies (such as Bell Atlantic) and their subsidiaries from providing "information services," which included, *inter alia*, making available information (such as video programming) that may be conveyed via telecommunications. *See United States v. Western Elec. Co.*, 552 F. Supp. 131, 227, 229 (D.D.C. 1982).

124. For purposes of summary judgment plaintiffs make no claim, and agree that nothing in the record on summary judgment shall be admissible for purposes of proving, that their business activities, other than the activities they maintain they would engage in but for 47 U.S.C. § 533(b), have suffered any adverse economic impact attributable to section 533(b).

125. For purposes of summary judgment plaintiffs make no claim, and agree that nothing in the record on summary judgment shall be admissible for purposes of proving, that the value of their property has been affected by 47 U.S.C. § 533(b), except to the extent its value might be enhanced were they legally permitted, and otherwise profitably able, to engage in the activities prohibited by section 533(b).

126. BVS, which was incorporated on September 24, 1992, has no revenue or income.

127. C&P's annual gross revenue and net income for the years 1980-1992, as reported to the Securities and Exchange Commission, is as follows:

	Gross Revenue ($000)	Net Income ($000)
1980	998,928	133,683
1981	1,156,078	144,671
1982	1,293,394	169,257
1983	1,369,674	193,118
1984	1,260,152	184,837
1985	1,370,835	213,349
1986	1,451,086	204,041
1987	1,502,474	225,946
1988	1,544,988	232,167
1989	1,568,677	202,955
1990	1,654,598	230,312
1991	1,715,179	(8,336)
1992	1,748,717	258,601

128. The losses reported in 1991 are not attributable to 47 U.S.C. § 533(b). Changes in the rules of accounting for benefits (other than pensions) owed to retired former employees required that C&P take an after-tax charge against its 1991 income in the amount of $224,083,000.

129. Comcast's September, 1992 telephone call from Philadelphia to London used wireline interexchange service from AT&T.

130. In the aggregate, local exchange carriers, such as C&P, still provide the majority of interexchange access service.

131. AT&T is the largest long-distance telephone company. According to March, 1993 testimony of its Chairman before Congress, in 1992 AT&T "paid mostly the local telephone companies something on the order of $14 billion to connect with our customers and access costs. $19 million were spent accessing customers through alternate access suppliers. That is, 98.86 percent of our customer access was accessed through local exchange companies."

Respectfully submitted,

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DATED: April 30, 1993

UNITED STATES DISTRICT COURT FOR
THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

[Caption Omitted in Printing]

City of Charlottesville	]	
	]	ss.
State of Virginia	]	

AFFIDAVIT OF GLEN O. ROBINSON

Glen O. Robinson, being duly sworn, deposes and says:

1. I am the Albert Clark Tate Jr. Professor of Law at the University of Virginia in Charlottesville Virginia.[1]

2. I have been associated with the University of Virginia since 1976. I taught at the University of Minnesota Law School, 1967-74, practiced law with the firm of Covington & Burling in Washington between the years 1961 and 1967 (with two years leave to serve in the Armed Forces). I was educated at Harvard College (A.B. 1958) and Stanford Law School (LL.B. 1961).

3. My principal fields in teaching have been Administrative Law, Antitrust, Communications, Property and Torts. I have done scholarly work in all of these fields and practiced law in the first three of them. In Communications I have published on all facets of the subject. I served as a Commissioner of the Federal Communications Commission (FCC) from 1974-76. I have also served as U.S. Ambassador to the 1979 World Administrative Radio Conference—an activity of the U.N. re-

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[1] A vita is attached.

sponsible for global radio frequency allocation and regulation—and as a consultant to the Department of State and the Committee on Telecommunications of the National Research Council, and to several private firms on communications issues.

I. Telephone Provision of Cable Service

4. It is important at the outset to stress that the issue here is not whether telephone companies (telcos)[2] should be permitted to offer cable service. The Cable Communications Policy Act of 1984, does not prohibit them from providing video programming service, *outside their home markets*, nor does it forbid offering channel service within home markets to *unaffiliated systems*.[3] Indeed, Southwestern Bell Corp. recently announced plans to buy and operate two large cable systems operating in the Washington metropolitan area.[4] In enacting restrictions on telco provision of cable service Congress adopted rules

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[2] "Telcos" refers throughout to local exchange carriers—the Bell Operating Companies and the GTE operating companies.

[3] Section 533(b)(1) of the Act makes it unlawful for any telephone common carrier: "to provide video programming directly to subscribers in its telephone service area, either directly or indirectly . . . ." Section 533(b)(2) makes it unlawful for such a carrier: "to provide channels of communications or pole line conduit space, or other rental arrangements, to any entity which is directly or indirectly owned by, operated by, controlled by, or under common control with such common carrier, if such facilities or arrangements are to be used for, or in connection with, the provision of video programming . . . ." (Emphasis added.)

Throughout this affidavit I use the phrase "cable service" to refer indifferently to the provision of video programming service (covered by § 533(b)(1) of the Act or provision of channels or conduit space to affiliated systems (covered by § 533(b)(2) of the Act).

[4] "Southwestern Bell to Buy Arlington, Montgomery Cable," Washington Post, February 10, 1988, p.C1.

first promulgated by the FCC in 1970.[5] In doing so it did not seek to forbid telcos from exercising their "electronic speech" rights, but rather to constrain the telco's opportunity to use monopoly power in the exercise of those rights. To be sure, this constraint on telco provision of cable services has given cable systems a measure of protection against one source of competition. However, it is misleading to suggest that this was designed as a strategy of simple protectionism.[6] The aim was not the suppression of competition in the provision of cable television service. The concern underlying those rules and the later legislation was that telephone company provision of cable service in their home markets would permit telcos to discriminate against cable systems in the provision of facilities and permit them to gain an unfair competitive advantage by means of cross subsidizing their cable operations with revenues from the telephone operations.

II. Congressional Versus Administrative Judgment

5. Unsurprisingly, the wisdom of these restraints has been a subject of recurrent controversy. In recent times, as plaintiff has detailed in its memorandum supporting

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[5] Certificate of Channel Facilities Furnished to Affiliated Community Antenna Television Systems, 21 F.C.C.2d 307 (1970), *aff'd sub nom.*, General Tel. Co. of Southwest v. United States, 449 F.2d 846 (5th Cir. 1971).

[6] *See* Affidavit of Thomas Hazlett, p.3, referring to the FCC's desire to "shelter" the infant cable industry from telephone competition. Considering the extraordinary regulatory constraints that were imposed on cable television at that time, it seems somewhat off the mark to describe the policy as one of protecting the cable industry. Be that as it may, the key point is that the policy did not preclude telco's from competing with cable, only from competing in home markets where there was the opportunity for strategic use of their monopoly power.

summary judgment,[7] the FCC has come to the view that the statutory restrictions on telco provision of cable service are no long necessary, and it has proposed that Congress the remove them.[8] The Department of Justice and the National Telecommunications and Information Administration (NTIA) are currently of the same mind. If this case involved judicial review of its rules, the FCC's views about regulatory policy would be entitled to some deference, of course.[9] It should go without saying, however, that the question before this court is not what the *FCC* reasonably thinks but what it is constitutionally acceptable for *Congress* to think, and Congress has chosen to think for itself, declining to repeal its earlier assessment of the need for restrictions on telco provision of cable services.[10]

6. To impose on Congress what the FCC, or the Department of Justice or NTIA, deems reasonable in regard to regulatory policy is always inappropriate given the different standards of judicial review that apply to

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[7] Plaintiffs' Memorandum in Support of Their Motion for Summary Judgment, pp. 14-17.

[8] *See* Second Report and Order on Telephone Company-Cable Television Cross-Ownership Rules, 7 FCC Rcd 5781 (1992) (hereinafter "FCC Second Report on Cross Ownership").

[9] As an aside it is doubtful that the court would owe *any* deference to the views of the Department of Justice or the NTIA since neither agency has any regulatory responsibility in this matter.

[10] In 1992 Congress did revisit other aspects of the 1984 Act—*see* Cable Television Consumer Protection and Competition Act, 106 Stat. 1460 (1992)—but it did not alter the 1984 restrictions on telco provision of cable service, despite the FCC's recommendations, of which Congress was quite fully aware. The FCC's Second Report appeared just prior to enactment of the 1992 Act, but the recommendations had been tentatively endorsed by the FCC at earlier stages in the rulemaking dating back to the original Notice of Proposed Rulemaking, issued in 1988. *See* FCC Second Report on Cross Ownership, para. 119.

Congress on the one hand and agencies on the other.[11] In this instance, however, there is special reason not to conflate agency and congressional judgments given that those judgments involve different assessments of the capacity and competence of the *agency* to deal with the problem at hand. The FCC does not now assert that the risks of anticompetitive discrimination or subsidization by telco provision of cable service in home markets that were found to be serious concerns in 1970 and 1984 have wholly disappeared. Though it has asserted that the risks "have been attenuated" by the growth of the cable industry[12] the agency concedes that the risks are sufficient to impose significant restraints on the telcos.[13] The gap between Congress and the FCC on how to deal with the telco problem reduces to a different assessment of the reliability of FCC regulations. The FCC believes that its own discretionary programs are sufficient to avoid the risks of anticompetitive conduct. Self-assessments are not inherently wrong, of course, but the bias on which they rest is always ground for others—Congress, the public and the courts as appropriate—to take a skeptical hard look at the assessment. This counsel comes with particular force in light of the history of telco regulation, a history of FCC frustration in controlling telephone company practices.

III. Reliability of FCC Regulation

7. Such has been the pace of change in the decade since the breakup of the Bell System in 1982 it is easy to forget that a central premise for the Department of

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[11] *See, e.g.*, Motor Vehicle M'frs. Ass'n v. State Farm Mutual Automobile Ins. Co., 463 U.S. 29, 43 n.9 (1983) (rejecting government's argument that agency rulemaking ought to be accorded same deferential respect accorded to Congress).

[12] FCC Second Report on Cross Ownership, para. 137.

[13] *Id.* at paras. 141-43.

Justice antitrust suit and resulting divestiture was the perceived inadequacy of FCC regulation to deal with the Bell monopoly.[14] The heart of that monopoly was the local exchange network.[15] The Modified Final Judgment (MFJ) dealt with that problem in two basic ways: first, it separated the local exchange service from nonlocal (interLATA) telephone services; second, it prohibited the local exchange companies—the Bell Operating Companies (BOCs) from providing competitive information services within the local markets where they had monop-

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[14] *See, e.g.*, comments of Judge Harold Greene in BARRY G. COLE, ED., AFTER THE BREAKUP: ASSESSING THE NEW POST-AT&T DIVESTITURE ERA 45 (COLUMBIA U. PRESS, 1991), P. 45: "It was the ineffectiveness of the FCC in coping with the problem of anticompetitive activity in the telecommunications industry that led to the antitrust suit and hence the decree in the first place." Judge Greene is harsher in his judgments about the FCC performance than I am inclined to be, but we agree generally that the regulatory track record (of both FCC and state regulatory authorities) in controlling anticompetitive conduct by dominant telecommunications firms has been, at best, uneven.

[15] As Judge Greene recently explained in United States v. Western Elec. Co., 767 F. Supp. 308, 314-15 (D.D.C. 1991), pet. for review pending.:

> "[I]n the instance of the Regional Companies [Bell Operating Companies], their market power stems from . . . their still almost complete domination over the "last mile" of the telephone network, i.e., their monopoly of the local wires and switches without which few, if any, competitors can reach the ultimate consumers of telephone-based information services. In fact, around ninety-nine percent of the traffic to the ultimate subscriber must still pass, in the end, through the Regional Companies' local loops. This basic circumstance gives these companies the ability to exercise market power with respect to the information services markets, that is, to raise price, to restrict output, or both. The Regional Companies would be able to raise price by increasing their competitors' costs, and they could raise such costs by virtue of the dependence of their rivals' information services on local network access."

olies. The latter restriction has been removed by the District Court for the District of Columbia (Judge Harold Greene), which has continuing jurisdiction over the MFJ.* The court's action, now pending appeal, was taken with reluctance and reservation. However, the court felt that it was bound by an unusually stringent burden of proof imposed by the court of appeals, a burden that required it to defer to the Department of Justice (which supported removal of the restrictions) unless it could be shown that the restrictions were strictly necessary to protect the public interest.** Of course, in

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* United States v. Western Elec. Co., 767 F. Supp. 308 (D.D.C. 1991), pet. for review pending. The district court's action came after an earlier refusal to remove the information services restriction from the MFJ was remanded by the court of appeals on the ground that the district court had applied the wrong burden of proof for judging whether the restriction was justified. 900 F.2d 283 (D.C.Cir.), cert. denied sub nom., MCI Communications Corp. v. United States, 111 S.Ct. 342 (1990). On remand the district court heard reargument on the information services restriction. Although the court remained convinced that the restriction should be retained, it believed that the burden of proof imposed by the court of appeals left no alternative but to order it removed.

** "In the opinion of this Court, informed by over twelve years of experience with violations in the telecommunications field, the most probable consequence of such entry by the Regional Companies into the sensitive information services market will be the elimination of competition from that market and the concentration of the sources of information of the American people in just a few dominant, collaborative conglomerates, with the captive local telephone monopolies as their base. Such a development would be inimical to the objective of a competitive market, the purposes of the antitrust laws, and the economic wellbeing of the American people. . . .

"For the reasons stated . . . when the Court tries to exercise its own judgment, it would conclude without hesitation that removal of the information services restriction is incompatible with the decree and the public interest. However, . . . the Court is not free to exercise its own judgment. Indeed, it has concluded that several rulings of the Court of Appeals in its 1990 opinion . . . leave

evaluating the information services restriction neither the district court nor the court of appeals was dealing with a congressional mandate, but only with a condition that had been incorporated into a consent settlement agreement between the Justice Department and AT&T, a settlement agreement in which the party on whose behalf the restrictions were imposed—the Justice Department—was actively pressing for their removal. Obviously, the present case is markedly different in respect to the character of the underlying mandate and the burden of proof issue. Whether or not Judge Greene was correct in believing that the information services restriction should be retained or correct in believing that he had no choice but to remove it, his careful opinion demonstrates the complexity of the underlying issues—which are, of course, the same issues that are implicated by the restriction on telco provision of cable service.

8. Central to Judge Greene's reluctance to remove the information services restriction from the MFJ was not simply the threat of anticompetitive conduct by the telcos but a persistent doubt about the adequacy of FCC regulatory controls to deal with it.[18] This is a claim the FCC has made before—often. My experience, like that of Judge Greene's (though from a different, and perhaps more sympathetic vantage point) causes me to be skeptical.

9. To begin with, assessing the FCC's claim for the efficacy of its regulatory strategies is extremely difficult without a stable point of reference. The FCC's recent proposal for dealing with telco provision of cable service is a case in point. In the event Congress accepts its proposed lifting of the restriction of telco provision of cable service, the Commission tentatively proposes to require telcos to provide video programming only through

it no choice but to remove the restriction. . . . It will accordingly do so, albeit with considerable reluctance." 707 F. Supp. at 808-09.

[18] 707 F. Supp. at 813-09.

separate subsidiaries.[19] This is an arresting proposal given that its *Computer III* decision recently abandoned structural separation as a condition of telco provision of competitive services generally.[20] The Commission did not explain why it proposes to retain a regulatory requirement for telco-cable video programming that it has rejected for other services. Perhaps the subsidization problem in the former case is more serious than in the latter, or perhaps it is just a matter of the regulatory right hand not attending to what the left hand is doing. Whatever the reason for the FCC's apparent ambivalence, there is every likelihood that the rules promulgated today will be changed tomorrow. *Computer III* decision, which sets forth the pertinent federal rules governing the competitive relationship between the BOCs and competitive service providers like cable television systems, is still pending judicial review following an earlier remand from the Ninth Circuit. The court of appeals had previously found that the Commission's decision to substitute regulatory oversight for structural separation had not been adequately explained or justified. On remand the Commission largely adhered to its earlier decision relying on nonstructural regulatory controls. Whether or not the court accepts the Commission's second decision one can only speculate how long the present rules will remain in effect. The structural-separation rules that *Computer III* replaced lasted not much longer than the duration of the rulemaking proceedings required to design the replacement rules.

10. The question of stability to one side any assessment of the efficacy of the rules must note their formid-

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[19] FCC Second Report on Cross Ownership, para. 141.

[20] Computer III Inquiry, 104 FCC 2d 958 (1986); 2 FCC Rcd 3035 (1987): 3 FCC Rcd 1135 (1988): 4 FCC Rcd 5927 (1989), *reversed and remanded sub nom.*, California v. FCC, 905 F.2d 1217 (9th Cir. 1990). Computer III Remand Proceeding, 6 FCC Rcd 7571, 7 FCC Rcd 909 (1992), pets. for review pending.

able complexity because the complexity of the rules is a fair indication of the complexity that the regulators see in the underlying problem. The complexity of the FCC's current regulatory scheme is also a guarantee that implementation and enforcement will not be easy. A scan of the FCC Record—almost any current volume will do—will reveal just how complex these rules can be. One might begin with a review of Commission rules explaining its Open Network Architecture (ONA) program and related rules, designed to provide conditions of nondiscriminatory access by competing service providers to telco facilities and basic services.[21] One could take the existence of these elaborate rules as evidence that the FCC is "on top of the problem," so to speak. However, that inference cannot be drawn without also drawing the inference that the problem is extraordinarily challenging—sufficiently so that reasonable minds (in and out of Congress) could question whether the FCC is equipped to deal with it. The slightest glance at the rules, and the Commission's seemingly endless outpouring of opinions explaining them,[22] will show that monitoring this mare's nest of complex regulations will require close regulatory attention.

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[21] Under ONA, the BOCs are required to offer an unbundled set of ONA services to enhanced service providers based on expected market demand, the services' utility as perceived by enhanced service competitors, and technical and costing feasibility. The nondiscrimination safeguards consist of Customer Proprietary Networks Information (CPNI) rules, network information disclosure rules, and nondiscrimination reporting requirements. Network information disclosure rules ensure that independent service providers receive access to technical information related to new or modified network services affecting the interconnection of enhanced services to the BOC networks. *See* Filing and Review of Open Network Architecture Plans, 4 FCC Rcd 1 (1988); 5 FCC Rcd 3084 (1990); 5 FCC Rcd 3103 (1990); 6 FCC Rcd 7646 (1991), *pet. for review pending.*

[22] The Commission's ONA orders are chronicled in Computer III Remand Proceedings, 6 FCC Rcd. 7571 (1991).

11. My own experience as a participant in the Commission's efforts to wrestle with these problems in the mid-1970's was that regulation achieved only limited success in preventing AT&T from practices that handicapped access to its facilities, and not much more success in preventing cross-subsidization of its services. And that success, such as it was, was achieved only at a large cost, to the agency, to competitors and ultimately to the public. It is difficult to convey a sense of this frustration merely by referring to particular controversies over, say, access arrangements or competitive pricing disputes.[23] The problem was too pervasive to be captured by any single illustration. In part the problem was one of AT&T constantly seeking to test if not bend the limits of agency standards, the effect of which was to put the Commission under a constant burden of surveillance. The problem of coping with the sheer volume of information (much of it unreliable) and argument (much of it rhetoric) was exacerbated by a basic uncertainty as to how the standards should be implemented.[24]

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[23] The major issues that come most immediately to my personal recollection are the interconnection disputes, that led up to the FCC's equipment registration program, see North Carolina Utilities Comm'n v. FCC, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977) (affirming FCC's registration program), the Execunet dispute; see MCI Telecommunications v. FCC, 561 F.2d 365 (D.C. Cir. 1977) (reversing FCC decision); and the disputes over competitive service tariffs, such as the Hi-Lo tariff, AT&T Co., 58 F.C.C.2d 362 (1976). Despite an abundance of rules and rulings these types of disputes were a continuous source of vexation to the Commission, and to the parties adversely affected by them, until *Computer II*.

[24] Again, my experience is broadly congruent with Judge Greene's observations: "Beyond the naturally still isolated examples of anticompetitive conduct discussed below, there is the overriding fact, which experience has validated again and again, that as a practical matter it appears to be impossible for regulators to devise simple rules to govern the many economic, technical, and financial circumstances affecting behavior in an area that is char-

12. The regulatory environment of the 1990's offers a replay of the 1970's. As in the 1970's there is, first, the task of ensuring that competitive service providers have nondiscriminatory access to basic network services and information controlled by the telcos, and, second, that of ensuring a "level playing field" for all information service providers by preventing cross-subsidization by the telcos of competitive information services. ONA purports to deal with the first task but, as the Ninth Circuit recently held, does nothing to prevent the second.[25]

13. The cross-subsidization problem was an important concern in 1970, and in 1984; it remains one today. My experience with the Commission's efforts to deal with the problem in the mid1970's leads me to challenge the FCC's claim to be able to police this problem with accounting rules[26] as a means of preventing cross-subsidization. The current cost allocation methodology is essentially the same (with greater liberalization in the definition of cost categories) as that adopted in 1976, when it first mandated fully distributed cost allocations.[27] Whether or not fully distributed cost methods are appropriate accounting conventions—as to which there is much dispute—

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acterized by technological change perhaps more than by any other factor. Yet unless the rules are quite simple and straightforward, the Regional Companies will be able to contend, again and again, that any particular rule is not applicable to whatever anticompetitive practices they may be engaged in, and to tie up enforcement almost indefinitely in administrative proceedings and in litigation." 767 F. Supp. at 319-20.

[25] California v. FCC, 90 F.2d 1217, 1234 (9th Cir. 1990).

[26] Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, 2 FCC Rcd 1298, 6283 (1987); 3 FCC Rcd 6701 (1988), *aff'd sub nom.*, Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C. Cir. 1990).

[27] AT&T Co., 61 F.C.C.2d 587 (1976); 64 F.C.C.2d 959 (1977); 67 F.C.C.2d 1441 (1978), *aff'd sub nom.*, Aeronautical Radio Inc. v. FCC, 642 F.2d 1221 (D.C.Cir. 1980).

what is important in this context is that, even using the costing methodology most restrictive of manipulations promoting subsidization, the Commission did not eliminate the threat of cross-subsidization in the 1970's. At bottom the problem was one of implementation, involving detailed scrutiny of cost information supplied by AT&T. The Commission was not able to carry out this task effectively. It admitted as much by adopting the structural separations requirement in *Computer II*.[28]

14. The reasons why the Commission's detailed cost allocation system, developed after years of proceedings, failed to work in practice are not difficult to understand, and there is little reason to believe that today's circumstances differ in any significant manner. First, during the 1970's, the Bell System often failed to provide the cost data required by the Commission's rules and engaged in almost continuous litigation over what those regulations required. Second, determinations of the legality of AT&T's rates were hung up in administrative proceedings for years, with potentially harmful consequences to competitors and ratepayers.

15. The FCC's monitoring problem has not disappeared. If anything it has increased. Contrary to some popular wisdom, the agency's difficulties in monitoring

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[28] In adopting its price-cap regime for AT&T the Commission claimed it would ameliorate the problem of cross subsidization by removing the incentive to engage in opportunistic cost shifting. Policy and Rules Concerning Rates for Dominant Carriers, 4 F.C.C. Rcd 2873, 2924 (1989). That claim was distinctly muted when it extended the price cap scheme to local exchange carriers. Second Report and Order on Policy and Rules Concerning Rates for Dominant Carriers, 5 F.C.C. Rcd 6786 (1990) (price caps for interstate services provided by Bell Operating Companies and the GTE Operating Company), *aff'd sub nom.*, National Rural Telecom Ass'n v. FCC, 988 F.2d 174 (D.C. Cir. 1993). The claim, which is open to dispute in any case, is largely irrelevant to the present case since the FCC's price cap scheme does not apply to most of the costs that are affected by the provision of local telecommunications services.

AT&T's responses to the emerging competition in the 1970's were only slightly a product of the latter's huge size, or the disparity in resources between the regulator and regulated. The main cause of regulatory burden was the number of different transactions that had to be monitored and the number of different players who were entering the market. Neither the transactions nor the players have diminished in number. The mere increase in the number of different regulated entities entails a nontrivial increase in regulatory burden. Overseeing one AT&T with seven regional divisions is not the same as overseeing seven independent firms, each with distinctive services, pricing policies and corporate goals. More important than the increased number of regulated entities, however, is the greater variety of active services, which in turn generates the need for new access arrangements between telcos and other independent service providers, which in turn generates more regulatory monitoring.

16. While the burden of the monitoring task has increased in the post-divestiture era, the FCC's ability to carry that burden has not. A 1987 General Accounting Office study of the FCC's plans and capabilities for controlling telco cross subsidies between competitive and regulated services concluded that the Commission did not have the requisite resources to deal with the problem. After noting that the elimination of structural separations safeguards (under the *Computer III* decision) put increased reliance on oversight methods, such as accounting audits, the GAO observed that the FCC's staff was inadequate to perform that oversight. Given agency staff levels and inspection schedules it was calculated that the major carriers or regional holding companies would be subject to audit "only once every 16 years." [29] The situa-

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[29] GAO, TELEPHONE COMMUNICATIONS: CONTROLLING CROSS SUBSIDY BETWEEN REGULATED AND COMPETITIVE SERVICES (Oct. 1987), p. 53.

tion has not improved since the time of the 1987 report: in February of this year the GAO revisited the issue and found no acceleration in auditing schedules an actual decrease in available auditors.[30] It should not be assumed, incidentally, that the slack in agency auditing is made up by the audits performed by CPAs hired by the telcos. The 1993 GAO report indicates that on-site audits by FCC auditors discovered "cases of misallocations totalling over $300 million in which carriers charged expenses to the regulated side of the business and carriers' affiliates had overcharged regulated carriers for services and supplies." [31] If $300 million in misallocated costs are discovered by an auditing capability that can audit carriers "only once very 16 years," one can only imagine the magnitude of misallocations that would be discovered by an adequately staffed agency. This is not a small problem, and one must doubt that misallocations of this order of magnitude can be dismissed as mere bookkeeping error.

IV. Reliability of State Regulation

17. Even assuming a more effective FCC regulatory policy than has been witnessed in the past years, the problem of guaranteeing fair competition between the telcos and cable systems does not rest with the FCC alone, as the Ninth Circuit decision in *California v. FCC* [32] had occasion recently to remind the FCC when it overturned the agency's blanket preemption of state regulation of intrastate enhanced services. In fact the FCC is not even in charge of the larger part of the business that is of immediate concern to this case: only 30% of all local

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[30] GAO, Telecommunications: FCC's Oversight Efforts to Control Cross-Subsidization (Feb. 1993), p. 4.

[31] *Id.* at 12.

[32] 905 F.2d 1217 (9th Cir. 1990).

exchange costs are regulated by the FCC; the rest is regulated by the states.[83]

18. The division of authority between the FCC and the state regulators has been hotly contested for many years, and it still has not produced clear and stable jurisdictional boundaries with respect to the terms and conditions of competitive access to basic telco services or the pricing of telco provision of enhanced services. Sorting out regulatory responsibility between state and federal regulators has been a vexing problem. In the most ideal conditions of harmonious cooperation between state and federal regulation defining regulatory boundaries is a difficult matter. As it happens, however, telecommunications regulation has not been characterized by such harmony. Throughout the 1970's the FCC fought a two-front war against AT&T on one front and state regulators on the other over the key issues of competition. In part the conflict between the FCC and state regulators was one of regulatory turf, but beneath the turf fight was a more basic clash over regulatory policy. The uneasy, and uncertain, relationship between federal and state regulators increases the uncertainty of regulation generally. In all events the unquestionably larger role that states now play in the telecommunications field means introduces new complexity to the question of how much reliance can be placed on regulatory oversight.

19. It is often remarked that state regulators have become more sophisticated and much better endowed with the necessary resources since the 1970's. I have no doubt this is true. If my recollection of state regulation during that period can be trusted, there was much room for improvement. But however much improvement there has been it does not alter the fact that regulatory policy across the nation is a highly variable, highly unreliable

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[83] Policy and Rules Concerning Rates for Dominant Carriers, 4 FCC Rcd 2873, 2882 n.7 (1989) (First Report and Order, adopting price caps for AT&T).

product. A survey of state regulators conducted in October 1990 offers a glimpse of the problem. Of forty-five states responding to the survey only 11 had adopted or had actively under consideration regulations comparable to the FCC's ONA regulations; the number of states reporting the existence or pendency of cost accounting regulations to deal with cross subsidization was somewhat more encouraging with 23 states having regulations designed to prevent cross subsidization.[34] Of course, having programs to deal with the problem is meaningless unless the regulators have the resources to implement them. The resources are as variable as the programs: the 1990 survey found that staff assigned to telephone regulation ranged from one (Mississippi) to more than 250 (New York).[35] Most of the states fall closer to the low than to the high end of this range.

V. Regulation, Competition and Speech

20. It is not the purpose of this affidavit to discuss the application of First Amendment standards to economic regulation, but it is pertinent to take note of what should be obvious: that any judgment about the constitutionality of these regulations entails a close examination of the government purposes they are intended to serve, not simply their incidental effects.[36] Plaintiffs have

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[34] Affidavit of Glen O. Robinson, October 1990, Attachment A, in United States v. Western Elec. Co., Civ. Action No. 82-0192.

[35] *Ibid.* In a number of states it respondents reported that agency staff are not assigned by utility. I assume that means that a staff member might do electric utility work one month and telco work another. Given the complexity of modern telecommunications issues nonspecialized work assignment cannot be explained on the assumption that utility regulation is interchangable, so it must be taken as a sign that the regulators are underfunded.

[36] *See, e.g.*, FTC v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411, 428-30 (1990) (upholding antitrust ban on boycott organized for communicative purposes); FCC v. National Citizens Committee

argued that the present restrictions are not the least restrictive alternative, but such an argument presupposes a careful examination of the efficacy of alternative regulatory strategies and the capability of regulators to enforce them not facile generalizations about competition and free speech. The boundaries of a summary judgment motion are too confining for the kind of examination of regulatory strategy that lies at the core of the present controversy.

21. In this respect the *Sable Communications* case,[37] relied on by plaintiffs, is a misleading guide to what is involved here. In contrast to the indecency regulations in *Sable* the restrictions on telco provision of cable service are not designed to suppress a certain kind of speech content or message. The regulations here serve an independent economic regulatory purpose. While that independent regulatory purpose does not render the regulations immune from First Amendment scrutiny, it does call forward a more nuanced understanding of regulatory impact and regulatory alternatives than is properly applied to regulation directed at the message content of speech.

22. Of course, the regulations here do affect only the telcos' "speech." But this can hardly be a ground for special suspicion given that it was only the telcos that have posed the threat of anticompetitive conduct. One could imagine a similar threat emanating from other businesses, as the plaintiffs contend. But the fact that other threats can be imagined does not alter the fact that, based on historical experience, only the telcos have

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for Broadcasting, 436 U.S. 775, 798-802 (1975) (upholding FCC ban on common ownership of newspaper and local broadcast stations); United States v. O'Brien, 391 U.S. 367, 376-77 (1968) (upholding criminal penalties for burning of draft card for symbolic purposes).

[37] Sable Communications, Inc. v. FCC, 492 U.S. 115 (1989).

been perceived to present a threat warranting regulatory concern.

23. The wisdom of the present restrictions on telco provision of cable service is a matter for serious debate, but the debate is only confused by forcing it into a debate about free speech. The real controversy here is about choosing among competing regulatory strategies for dealing with an economic problem that has existed, in largely unchanged form, for over twenty years. It is a controversy about the reasonableness of Congress' choice of economic regulatory strategies not about its choice of speech.

/s/ Glen O. Robinson
GLEN O. ROBINSON

[Notarization Omitted in Printing]

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA

[Caption Omitted in Printing]

AFFIDAVIT

DISTRICT OF COLUMBIA, S.S.

Bruce M. Owen, being duly sworn, deposes and says:

1. I am the president of Economists Incorporated, a Washington DC economic consulting firm, and visiting professor of economics at Stanford University's Washington DC campus, where I teach courses on regulation and law and economics. I have published a number of books and articles dealing with telecommunications. From 1979-1981 I was Chief Economist at the Antitrust Division of the U.S. Department of Justice. Previously I was Chief Economist at the White House Office of Telecommunications Policy. I testified as an expert on behalf of the government in *United States v. Western Electric,* the antitrust lawsuit that led to the dissolution of the Bell System in 1984. A copy of my curriculum vitae appears as Appendix A to this affidavit.

2. I have been asked by the National Cable Television Association, Intervenors in this proceeding, to address the economic basis for the prohibition on local telephone companies' providing video programming in their telephone service areas in 47 U.S.C. § 533(b).

3. I believe that the restrictions on telephone company provisions of video services (practically, of cable

television service) were economically justified at the time of their adoption by the FCC in 1970, and remained justified when the restrictions were codified by Congress in 1984. Further, although the conditions justifying these restrictions are less compelling today than in 1984, the restrictions remain sound and will continue to be so for some time to come. My conclusions are based on, and limited to, the economic role of the restrictions in the context of United States competition policy.

4. Restraints on the competitive activities of firms are unusual and should be imposed only in abnormal and convincing cases. Such restrictions should have a sound conceptual basis and be supported by empirical evidence that they are necessary to preserve competition in particular circumstances. I believe such restrictions are appropriate in this case, however, to prevent likely anticompetitive behavior on the part of local telephone companies in cable television. This view is based not only on analysis of the ability and economic incentives of regulated local telephone companies to engage in anticompetitive behavior but also on the ample evidence that local telephone companies have actually engaged in monopolistic practices in the past.

5. I assume for purposes of my analysis that local telephone companies now have the ability to offer regulated common carrier facilities for the transmission of video programming provided by third parties. The restriction in § 533(b) applies to the business of packaging and marketing programming, not transmitting it. Thus, if it made economic sense for telephone companies to provide the underlying transmission facilities for cable television, they could do that now. Indeed, virtually all of the alleged competitive benefits from telephone company entry into video programming that Professor Hazlett discusses

in his affidavit would flow from video transmission competition by telephone companies currently permissible under § 533(b). That is, if telephone companies provided an alternative competing local transmission facility for video programming, competing program packagers and producers could readily enter the market using those facilities to provide video services to consumers. [If such facilities-based competition made economic sense, it should already be occurring and § 533(b) does nothing to prevent it. If new technology makes such competition feasible in the future, § 533(b) will not stand in the way.] Moreover, if telephone companies—because of their resources and technical know-how—are able to provide better services or prices than incumbent cable operators, nothing stops telephone companies from competing on equal terms with cable operators outside their telephone service areas.

6. Telephone companies may claim there is insufficient incentive for them to provide underlying video transmisison facilities without the ability also to offer video programming services. This is an extraordinarily dubious claim. For more than one hundred years, the business of telephone companies has been to provide common carrier telecommunications facilities for the use of others. Telephone companies do not originate the conversations that give rise to a demand for their transmission service. Just as with telephone conversations, there are no obvious economies of scope or of vertical integration arising from both laying fiber optic cable and producing or buying and then packaging video programming. Why should the cost of providing transmisison service be lower because the telephone company provides video programming? The case of cable television companies is distinguishable, because at the time cable

companies developed there was an insufficient supply of video programming for cable television. By integrating vertically, cable companies expanded the demand for their services. Today, there is a very substantial video programming industry already in existence and ready to supply service at competitive rates.

7. The danger in permitting telephone companies to provide video services in competition with other local sources of video programming involves sequential telephone company encroachment on two related activities. First, telephone companies are likely to exploit their ability to engage in cross-subsidization to eliminate competition in the local transmission of video services. Monopolization of underlying facilities to transmit video services will result in an *increase in the price of local telephone service.* Having eliminated competing means of access to viewers, telephone companies are then likely to displace more efficient providers of, and to tend to monopolize, the provision of video services as a further means to evade the regulatory constraint they face as facilities-based common carriers.

Competition Policy and Regulation

8. Competition has a pivotal role in our private market economy, and has long been a central goal of public policy. The Supreme Court has characterized our national policy of competition as follows:

> Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free enterprise system as the Bill of Rights is to the protection of our fundamental personal free-

doms. *United States v. Topco Associates,* 405 596 at 611 (1972).

9. Competition protects the interests of consumers in efficient prices, cost-effective production, and technological progress through its effects on the economic incentives facing sellers. Competition assures that sellers who serve consumer interests survive and prosper; those who do not fail and are replaced by others.

10. The process of competition sometimes fails, calling for public policy responses. Sellers, for example, may form cartels, or seek through merger to achieve monopolies. In addition, monopolists may attempt to exploit their market power in unacceptable ways, or to extend it to other markets. These threats to the process of competition are regulated through the antitrust laws. Many communications laws, in fact, including § 533(b), are simply industry-specific applications of the broader principles underlying the antitrust laws. In addition, the pricing and other decisions of certain monopolies are regulated directly by public utility commissions.

11. A familiar problem in competition policy is that of "leveraging," which occurs when a monopolist in one market seeks to leverage its market power into a second market. Such problems may arise, for example, in the case of tying. *See generally, Eastman Kodak Company v. Image Technical Services* 112 S.Ct. 2072 (1992). Leveraging is most likely to be a problem where circumstances prevent a monopolist from exploiting its economic power fully in the primary market; in such cases, encroachment upon a second market may enable the monopolist to extract additional profits from its primary market. Competition policy condemns this for two reasons. First, customers in the primary market are injured by being

required to pay more for the monopolist's goods. Second, the monopolist injures competition in the second market by displacing more efficient competitors, and perhaps even by monopolizing the second market. Thus, consumers are harmed in both markets.

12. It has been recognized for more than thirty years that one species of leveraging exists because classic public utility rate regulation creates incentives to engage in anticompetitive behavior.[1] Traditional public utility regulation requires a monopolist to price on the basis of the cost of providing service, to which is added a fair rate of return on invested capital. If the resulting price is less than the monopolist's profit-maximizing price, such regulation creates incentives for the utility to avoid, evade, or ease its regulatory constraint. In certain circumstances, this evasion can be achieved by invading a second market and displacing more efficient competitors in that market. Professor Kahn describes regulated monopolists'

> . . . tendency to reach out for additional business, inside or outside the sphere of their franchised public-utility operations, if need be at rates below incremental costs. . . . [T]his kind of behavior is most likely to be encountered in

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[1] Averch and Johnson, *Behavior of the Firm Under Regulatory Constraint*, 52 Amer. Econ. Rev. 1052 (1962). For a fuller development of the theoretical issues raised by cost-of-service-regulated monopoly firms participating in competitive activities, *see* Brennan, *Why Regulated Firms Should Not Be Allowed in Unregulated Markets: Understanding the Divestiture in* U.S. v. AT&T, 32 Antitrust Bull. 741 (1987); Brennan, *Cross-Subsidization and Cost Misallocation by Regulated Monopolists*, Journal of Regulatory Economics (1990) 37, and Noll and Owen, *United States v. AT&T: The Economic Issues*, in J. Kwoka and L. White, eds., The Antitrust Revolution, (1989, rev. ed. 1993).

> competitive situations, because it is there that the elasticity of demand may require unremunerative rates if the regulated company is to obtain the business and in this manner to increase its rate base. A. Kahn, 2 The Economics of Regulation: Principles and Institutions 54 (1971) [footnote omitted].

13. Invasion of secondary markets helps a regulated monopolist evade regulatory constraint by creating opportunities to inflate the apparent costs of providing its primary monopoly service. If services in the second market are provided using common items of equipment or personnel, or if the services produced in the second market are used in the primary business, opportunities generally exist to engage in behavior that has the effect of increasing the apparent costs of providing the primary monopoly service. Professors Laffont and Tirole describe two such opportunities:

> A. *Accounting arbitrage.* The firm engages in accounting manipulations. Labor, raw material, and other inputs are imputed to any activity for which they are not used. The transfer prices for intermediate goods traded between divisions is set at the wrong level.
>
> B. *Allocative arbitrage.* The general office allocates its effort or attention to those activities that face the most powerful incentive schemes rather than to minimize total cost. To these activities are dedicated the best engineers or inputs. There is no imputation of expenses of one activity on another, but rather more attention is paid to certain activities. J.-J. Laffont and J. Tiorle, A Theory of Incentives in Procurement and Regulation 188 (1993).

14. Encroachment on the second market, because it generates additional monopoly profits in the first, may be profitable even when pricing below cost is required in order to make such inroads. This anti-competitive "cross-subsidization" may amount to indefinite predatory pricing in the competitive market. Such predatory pricing is profitable to the regulated firm from the outset. (In contrast, in traditional predatory pricing, the monopolist must eventually raise prices in order to recoup losses and enjoy the fruits of its predation. *Matsushita Elec. Indus. Co v. Zenith Radio Corp.* 475 U.S. 574 (1986) at 588-89.) Similarly, activities, even costly activities, that reduce the market share of rivals in the second market by increasing rivals' own costs, may be profitable. In either case the effect is an anticompetitive (i.e., injurious to consumers) partial or complete foreclosure of the market to competitors.

15. A second antitrust problem arises when there is a vertical relationship between the regulated monopoly and the unregulated or less strictly regulated competitive activity. Two entities are vertically related when one supplies a product that is used by the other as an input in production. Suppose a firm has a regulated monopoly in an "upstream" or input activity (for example, transmission facilities for video programming) that is essential for an unregulated downstream activity (for example, video programming services).[2] The vertical relationship affords

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[2] In the context of video programming services, it is ambiguous which activity (programming or transmission) is an "input" because it depends on which entity is ultimately offering service to the public. If 533(b) were abolished and telephone companies offered integrated video programming over their own transmission facilities, programming would be an input, and therefore "upstream", of the final integrated service sold to consumers. Alternatively, transmission can be regarded as an input for a com-

such a firm opportunities to exercise increased market power in transmission and to realize the resulting higher profits in the unregulated activity. By discriminating against competing packagers of video services needing access to its monopoly transmission facility, the unregulated vertically-integrated video program supplier may be able to sell programming at inflated prices to retail customers. Further, in some circumstances the integrated monopolist can sell programming to itself at inflated prices in order to earn excessive profits.

16. The problems described above are quite general; they are not limited to telephone companies, or within telephony to the issue of cable television. For this reason, for example, the effects on horizontal competition to vertical acquisitions in regulated industries are a subject of special scrutiny under the Clayton Act. *See United States Department of Justice Merger Guidelines,* issued June 14, 1984 at § 4.23. (The 1984 *Guidelines* were superseded by the *Department of Justice and Federal Trade Commission Horizontal Merger Guidelines* issued April 2, 1992. However, according to a statement accompanying the 1992 *Guidelines,* various provisions of the 1984 Guidelines, including § 4.23, remain in effect.)

17. For example, the California Public Utilities Commission not long ago turned down a request by Southern California Edison to acquire a neighboring electric utility, San Diego Gas and Electric. The CPUC concluded that the proposed merger raised serious competitive problems because it would facili-

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peting video packager that uses common carrier transmission facilities to deliver programs to the public. In this affidavit, I use the convention of describing programming as an upstream input because I am concerned with the dangers presented by a vertically integrated telephone monopolist.

tate evasion of regulation as contemplated by § 4.23 of the 1984 *Merger Guidelines. Southern California Edison and San Diego Gas and Electric*, California Public Utilities Commisison Decision 91-05-028, Application 88-12-035, (1991) at 79.

18. Similarly, the Department of Justice recognized that regulated electric utilities might engage in monopoly behavior with regard to markets for coal in order to evade regulatory constraint. *Competition in the Coal Industry: Report of the U.S. Department of Justice Pursuant to Section 8 of the Federal Coal Leasing Amendments Act of 1976 for Fiscal Year 1979* (1980) at 62ff.

19. Where problems such as those described in the examples above are found as isolated instances, they are treated under the antitrust laws or regulatory statutes on a case-by-case basis. Where they are pervasive and predictable consequences of regulation and industry structure, they are best dealt with through prophylactic rules.

20. The case of local telephone utility provision of video programming services is a particular instance of the problem that I have been describing. In traditional antitrust leveraging analysis, incursions by telephone companies into cable television could be treated as simple extensions of monopoly based, for example, on the market power of telephone companies over "bottlenecks" such as essential inputs required to provide cable service; poles and conduit space are examples. Modern economic analysis emphasizes as the basis for this incursion the opportunity it creates for a telephone monopolist to evade regulatory constraint and thus to enjoy a greater fraction of the potential unregulated monopoly profits from the provision of telephone service. The incentive to engage

in anticompetitive conduct in a second market is not eliminated by regulation of that market. Differences, either in regulatory treatment, *e.g.*, allowed rate or return, or in the elasticities of demand in the two markets, are generally sufficient to make it profitable for a regulated telephone company to expand in order to evade regulation of its telephone profits. Thus, while control of essential facilities is an element of the raising-rivals'-costs branch of the theory, it is by no means a necessary element. Profitable cross-subsidization does not require that the regulated utility control essential facilities.

21. In the next section, I describe in more detail the conditions that give rise to concern for competition when local telephone companies are permitted to enter local markets for video programming.

Anticompetitive Incentives of Local Telephone Companies

22. The expansion of a cost-of-service regulated local telephone company into the provision of video programming services threatens competition because such a combination is likely to allow the telephone company to evade the constraint that regulators have placed on its exercise of market power. For example, by allocating costs for both regulated monopoly telephone services and video transmission service to the regulated telephone operations, the firm may obtain regulatory approval for an increase in prices for its telephone services. Telephone companies' use of common facilities to provide both telephone service and video transmission services distinguishes telephone companies from, for example, electric utilities with regard to the provision of video services. Electric utilities would not for the most part provide video services on the same facilities used to deliver electric power, and hence would have substantially less opportunity to engage in cross-subsidization.

23. A price increase due to cross-subsidization involves an exercise of market power. The firm realizes increased profits at the expense of consumers. While the increased profits actually come from the regulated activity, from an accounting point of view they appear to accrue to the competitive activity. Similarly, having wholly or partly foreclosed competitors for transmission of video programming through such cross-subsidization, the regulated telephone company can foreclose competing video programming suppliers from its facilities and earn even higher profits on its video offerings. The incentive to foreclose competition flows from the constraints regulators place on the profits from the underlying transmission monopoly.

24. As I have already noted, the exercise of additional market power in the regulated telephone market, that is, evasion of rate regulation, is not the only problem that arises from the expansion of regulated monopoly telephone firms into competitive activities. This cross-subsidization of the competitive activity can inflate artificially the regulated telephone company's market share in the competitive market and eliminate more efficient competitors there.

25. The foreclosure of efficient video transmission competitors through cross-subsidization is exacerbated to the extent that local telephone companies also control bottleneck facilities. It is plaintiffs' contention that cable television systems are local monopolies. Hazlett Affidavit at ¶¶ 4-16. Cross subsidization by a telephone company which forecloses competition from cable companies would give the telephone company a transmission monopoly. The telephone company that provided program services would have the ability and incentive to discriminate against its video programming packager competitors who as a result

of the transmission monopoly may need access to its facilities to reach consumers.

26. The early history of cable television involved telephone companies' attempts either to deny access to cable companies or to charge them exorbitant fees for use of telephone facilities. Actual anticompetitive behavior on the part of telephone companies against cable television companies in the 1960s provided a sensible basis for the FCC to prohibit telephone companies from providing cable television services in 1970. In addition, the Pole Attachment Act of 1978, 47 U.S.C. § 224, was a partial response to these problems and provided regulatory oversight of charges for use of telephone facilities by cable companies.

27. If discrimination such as that described succeeds in raising rivals' costs, that will increase prices for video programming services above competitive levels, permitting the regulated telephone company to earn above-competitive profits in video programming services. Attempts by regulators to control the prices and profits telephone companies might earn in video programming services do not eliminate the incentives on the part of vertically-integrated telephone companies to exclude more efficient providers of video programming services. Due both to likely differences in regulatory treatment and in the elasticities of demand for telephone services versus video programming services, telephone companies generally will find it profitable for foreclose efficient competitors. The net effect is to raise costs and prices in both markets.

28. Finally, telephone companies' incentives to exclude cable companies from the market and to monopolize video programming services are magnified because cable companies with sophisticated fiber networks pre-

sent a potential competitive threat to local monopoly telephone services. *See* Stipulations 43 and 45; Plaintiff's Memorandum at 12; Hazlett Affidavit at ¶ 37.

29. The extension of a regulated monopoly into other markets may be harmful to competition in a variety of circumstances. The particular conditions that give rise to this danger in the case of local telephone company provision of video services are:

Market Power: Telephone companies characteristically have market power in the provision of local telephone services so that, absent regulation, they would be able to increase profits by raising telephone prices above the competitive or regulated level.

Regulation: Local telephone companies characteristically are subject to cost-based regulation that constrains prices to be below the prices that would maximize profits and that these firms would charge in the absence of regulation. In other words, local telephone companies have unexercised market power as a result of regulation. As I indicate *infra*, newer forms of regulation such as price caps still leave telephone companies with the incentive and ability to evade regulatory constraints.

Common Facilities: Local telephone companies have a substantial opportunity to engage in cross-subsidization when, as here, both the competitive video transmission service and the monopoly service are provided on common facilities with common costs. Stipulations 87, 88, and 97; Hazlett Affidavit at ¶ 32. Common costs mean that cross-subsidization is virtually impossible to detect and eliminate. It is the existence of significant common costs which differentiates telephone companies from electric utilities.

Competitive Activity: Local telephone companies expanding into program packaging typically would

face existing and potential providers of video services such as cable, wireless cable (MMDS), video rental outlets and direct broadcast satellite (DBS) providers. Because they would face competition, their expansion would reduce the market shares of rivals, including ones that may have lower costs or superior products.

Imperfect Regulation: Local telephone companies can reasonably expect to be able to obtain approval for an increase in their regulated telephone prices based on the higher costs that result from cross-subsidizing video transmission activities. In other words, regulatory agencies are not able to monitor the regulated telephone services and video services perfectly.

Vertical Relationship: Local telephone companies also have a substantial opportunity to engage in cross-subsidization when, as here, the competitive activity (program packaging) will be selling to the regulated entity. This "self-dealing" situation invites overcharging for input services in order to increase the apparent costs and therefore the permitted price of the regulated service. Moreover, in order to minimize the effectiveness of regulators in monitoring such transfer pricing, the telephone company will have incentives to deny the programming to competing distributors.

History of Anticompetitive Behavior by Telephone Companies

30. Concern on the part of the FCC and the Congress with the anticompetitive potential in telephone company provision of video services did not arise in a vacuum. The 1960s and 1970s were a period of great turmoil in telecommunications policy—one in which the federal government was promoting with

increasing urgency a role for competition. The long-standing telephone monopoly was falling into disfavor. The government was acutely aware that the Bell System opposed this policy. The local telephone companies owned then by AT&T engaged in exactly the practices described above in various nascent competitive markets for equipment and service, including anticompetitive activities against cable television companies. *See United States v. Western Electric*, Plaintiff's First Statement of Contentions and Proof 202, 239 (November 1, 1979). One result was the antitrust action that culminated in the dissolution of the Bell System. The Bell System was dissolved, amid prophylactic restrictions on the ability of local telephone companies to enter competitive markets, in 1984, the very year that § 533(b) was codified.

31. Thus, Congress had ample evidence that telephone companies respond to the incentives they face and engage in anticompetitive behavior. In *United States v. Western Electric*, the government's antitrust suit charged that, through inflated prices between vertical affiliates, cross-subsidization, and discrimination against rivals, the Bell System had violated the antitrust laws by (i) charging anticompetitive service and equipment prices to the customers of its regulated local telephone services, and (ii) using its status as a regulated monopoly in local telephone service to foreclose competition in and monopolize the potentially competitive long-distance telephone service and telephone equipment markets. The government called as witnesses several former Federal Communications Commission officials who testified to the ineffectiveness of regulation in preventing such abuses. The government's view was that regulators could not regulate the Bell System adequately. The Justice Department stated at the time that:

> At the heart of the government's case in *United States v. AT&T* was the failure of regulation to safeguard competition in the face of the powerful incentives and abilities of a firm engaged in the provision of both regulated monopoly and competitive services. Neither of these problems [cross-subsidization and discrimination] has thus far proven amenable to successful regulatory solution. Indeed, the very basis for divestiture is that the anticompetitive problems inherent in the joint provision of regulated monopoly and competitive services are otherwise insoluble. U.S. Department of Justice, *Response to Public Comments on the Proposed Modification of Final Judgment*, 47 Fed. Reg. 23, 320-336, May 27, 1982, quoted in *United States v. Western Elec. Co., Inc.*, 673 F. Supp. 525, 568, DDC 1987.

32. Opinions by the U.S. District Court for the District of Columbia on related issues, such as attempts to remove line of business restrictions agreed to by the Regional Bell operating companies in the consent decree in *United States v. Western Electric*, have upheld repeatedly the validity and applicability to present circumstances of the economic theory I have articulated, and that was relied upon by the Department of Justice. According to the Court, regulators were indeed unable effectively to monitor the behavior of telephone companies: [8]

> . . . . [T]he Court concluded following the close of the Department's case, and in accordance with the arguments presented by the Department, that "the Commission is not and never has been capable of effective enforcement of the

[8] The quotations below are from *United States v. Western Electric*, 673 F. Supp. 525 (DDC 1987), footnotes omitted.

> laws governing AT&T's behavior," and that accordingly AT&T had been able to violate the antitrust laws in a number of ways over a long period of time with respect to interexchange (long distance) services and the procurement of equipment. . . . 673 F. Supp. 531.
>
> . . .
>
> [T]he FCC was unable to prevent or to remedy major anticompetitive abuses by the Bell System achieved through the activities of its local affiliates. . . . The Department of Justice argued, and at the trial it introduced voluminous expert testimony and other evidence in support of its argument, that the local exchanges are so complex and so technically dynamic, and that they comprehend so many and such complex joint and common costs, that regulation could not prevent anticompetitive activities. . . . 673 F. Supp. 567-68.

Further, the Court has noted that the telephone companies retained the local monopolies that permitted leveraging to other, competitive markets and which are critical to the economic basis for restricting telephone company participation in related markets:

> The Court found that, were the Regional Companies allowed to be present in the interexchange market while they also maintained monopoly control of the local telephone markets, they would be able to pursue precisely the same course as had the Bell System: (1) to discriminate in a variety of ways against their nonmonopoly competitors through judicious use of the local monopoly; and (2) to "subsidize their interexchange prices with profits earned from their monopoly services." 673 F. Supp. 542 . . . [T]heir monopoly bottlenecks are as solid and pervasive as they were when the decree was en-

> tered. It is equally clear that nothing has occurred to change the decree conclusion that those in control of the local bottlenecks have the incentive and ability to use their monopoly power anticompetitively in the interexchange market. . . . 673 F. Supp. 546.

Moreover, the Court found the telephone companies have the power to "raise rivals' costs," just as economic theory predicts:

> The manufacturing restriction was based in substantial part on evidence presented by the Department of Justice at the trial of this case indicating that the Bell System had improperly monopolized the market for telecommunications equipment, in that its local Operating Companies purchased such equipment primarily from Western Electric Company, the System's manufacturing affiliate, and "engaged in systematic efforts to disadvantage outside suppliers." 673 F. Supp. 552 . . . As testimony and other evidence demonstrated, the Operating Companies managed, by one stratagem or other, to purchase Western Electric's products, even when those products were more expensive or of lesser quality than alternative goods available from unaffiliated vendors. 673 F. Supp. 553 . . . The Bell System subsidized the prices of its equipment with the revenues from the Operating Companies' monopoly services. The effect of this practice, as with respect to cross-subsidization generally, was (1) to permit the Bell System to undercut other producers of equipment (which lacked such a subsidy), and (2) unfairly to burden the consumers with excessive rates for the monopoly services they were furnished by the Operating Companies. . . . 673 F. Supp. 553-54.

In sum, the Court affirmed both the conceptual and empirical validity of the very economic theory I have articulated in this affidavit, and confirmed that the conditions were present to justify a restriction on the freedom of regulated local telephone companies to enter competitive markets:

> [M]any of the current operations of the Regional Companies take place in unregulated markets. This complex mixture of regulated and unregulated activities provides these companies both with a powerful temptation and with ample opportunity to commit anticompetitive abuses in the competitive markets and to subsidize their competitive operations with profits earned in the monopoly markets. 673 F. Supp. 569.

33. The anticompetitive problems associated with telephone company participation in competitive markets did not end with the dissolution of the Bell System in 1984. Because the local telephone companies remained regulated monopolies, they continued to seek opportunities to earn greater profits by breaking out of their regulatory constraints. For example, an audit of BellSouth by a NARUC task force in 1985 found cross-subsidies of new, competitive businesses from regulated telephone activities. Special Accounting Task Force of the Southern Public Service Commissions, *Report on the BellSouth Corporation,* (May 16, 1985) at 11. These practices by BellSouth were found to have continued in 1990. A California Public Utilities Commission audit of Pacific Telesis in 1986 also found cross-subsidies of unregulated businesses. California Public Utilities Commission, *Audit Report on Pacific Telesis,* (July 11, 1986) at 15. A NYNEX purchasing subsidiary overcharged regulated phone operations $118 million between 1984 and 1988 and was fined $1.4 million by the FCC. FCC,

Review of Affiliate Transactions Between NYNEX's LECs and Materiel Enterprises, (1989). US West admitted in 1991 to favoring its competitive switching offerings in granting access to its local network and paid a $10 million fine. Memorandum of the United States in Support of Motion and Stipulation for Entry of an Enforcement Order, *United States v. Western Electric Co.*, Enforcement Order, February 15, 1991. The Georgia Public Service Commission determined that Southern Bell Telephone, a telephone company of BellSouth Corporation, used its monopoly control of the local exchange market to impede competition in the voice messaging services market by discriminatorily denying competitors access to the local exchange network, and that "substantial issues of predatory pricing and cross-subsidy [had] been raised" with regard to the pricing of the service. *Order of the Commission, In the Matter of the Commission's Investigation Into Southern Bell Telephone and Telegraph Company's Provision of MemoryCall Service*, Docket No. 4000-U, at 67-68 (June 4, 1991). In 1992, Southern Bell agreed to pay approximately $15.2 million to more than 900,000 customers to resolve a grand jury investigation into charges that Southern Bell, *inter alia*, had intentionaly overbilled customers through the fraudulent sale of optional telephone services. In accepting the settlement, the grand jury issued a report recommending "stricter controls on the cost allocation procedures . . . to prevent the unlawful subsidy of the unregulated side by the regulated side." Press Release, Department of Legal Affairs, Florida Office of Statewide Prosecution (Oct. 9, 1992). A 1992 audit commissioned by the Louisiana Public Service Commission identified "numerous instances where BellSouth affiliate transactions were structured to benefit the Company's nonregulated ac-

tivities." *Report to the Louisiana Public Service Commission, Ratemaking and Financial Audit of South Central Bell Telephone Company,* Docket No. U-17949, Subdocket A, at ix (Aug. 1992). Indeed, the anticompetitive activities of the divested Bell Regional companies led the District Court to conclude in 1987:

> The Regional Companies are of course limited in the breadth and scope of the anticompetitive activities in which they are able to engage inasmuch as the most effective vehicles for such activities are beyond their reach due to the existence of the core restrictions of the decree. What is startling, however, is given the relative paucity of the field available for such acts, in how many ways these companies appear nevertheless to have managed to discriminate and to cross-subisdize. *United States v. Western Electric,* 673 F. Supp. 525, 580, footnote omitted.

Continued Existence of Anticompetitive Threat

34. The conditions sufficient to create the significant potential for anticompetitive harm by the expansion of local telephone companies into competitive activities still exist today with respect to telephone company entry into video programming services. For example, despite the emergence of competition for some local telephone services, basic local telephone service retains substantial monopoly characteristics. Stipulation 131.

35. Moreover, the market power of local telephone companies remains constrained by cost-of-service regulation. It has been argued that new forms of incentive regulation have reduced or eliminated the incentive of local telephone companies to engage in anticompetitive cross-subsidization. This type of regulation typi-

cally imposes price caps on regulated services and allows carriers greater profits if they are able to reduce their costs. If price caps, fixed in real terms, were kept in place for a long time, this type of regulation would not permit prices to increase if telephone companies' costs increased. In theory, price-cap regulation applied in that way could reduce or eliminate the incentive to shift costs to regulated services because those higher costs would no longer be recovered in higher prices for monopoly service. *See* Braeutigam and Panzar, *Diversification Incentives Under "Price-Based" and "Cost-Based" Regulation*, 20 RAND Journal of Economics 373 (1989).

36. In practice, however, telephone price-cap regulation does not ignore the profits and costs of the regulated firm. Telephone price caps typically are set, and periodically reset, on the basis of historical accounting costs. (In contrast, the price caps recently established by the FCC to govern cable television service rates are based not on historical costs but on comparisons with the rates charged by cable systems that face "effective competition". *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, Report and Order, Docket MM-92-266- (released May 3, 1993), —FCC Rcd—(1993). Moreover, if profits are high, regulators will be under political pressure to reduce allowed prices. Conversely, low profits will bring pressure on regulators to allow higher prices. In other words, accounting costs and profits are likely in the real world to affect the price caps, and telephone companies are likely to take that into account in setting their course of conduct. But once regulatory constraints on prices are again tied to costs, they can be affected and, therefore, partially evaded by telephone companies' behavior. The regulated telephone

companies will retain the incentive to shift costs to regulated monopoly services and away from competitive activities. *See* Braeutigam and Panzar at 389. Further, these eventualities are reasonably foreseeable and thus likely to affect behavior in the present.

37. I conclude that under current conditions the prohibition on telephone company provision of cable television services remains necessary to prevent the likely monopolization of those services by local telephone companies. If the prohibition were removed, I believe it is likely that local telephone companies will use their regulated telephone revenues to cross-subsidize video programming transmission services and use their resulting control of essential facilities to discriminate against their video programming competitors. My conclusions about the risks today from telephone company provision of cable television services are echoed by the District Court's warnings in 1987 about telephone company expansion into related fields:

> The Regional Companies are now requesting entry into far broader competitive fields of endeavor than any in which they were permitted to function during the last three years. Based upon their performance during that three-year period, it would not be unreasonable to assume that cross-subsidization would also take place with respect to these new markets, and that it would occur on a far wider and more destructive scale than heretofore. That is so if only because cross-subsidies are much more easily concealed where—as between local exchange service and interexchange, telecommunications manufacturing, and information services—there are many common costs that can be attributed, almost at the companies' unfettered choice, to any of the

> various activities, than where cross-subsidization is attempted between exchange service and ventures foreign to telecommunications. *United States v. Western Electric*, 673 F. Supp. 525, 582-83.

The Court in 1991 once again affirmed the economic theory and the necessary underlying conditions for restricting telephone company expansion into competitive areas:

> In the opinion of the Court, informed by over twelve years of experience with evidence in the telecommunications field, the most probable consequences of such entry by the Regional Companies into the sensitive information services market will be the elimination of competition from that market and the concentration of the sources of information of the American people in just a few dominant, collaborative conglomerates, with the captive local telephone monopolies as their base. Such a development would be inimical to the objective of a competitive market, the purpose of the antitrust laws, and the economic well-being of the American people. *United States v. Western Elec. Co., Inc.*, 767 F. Supp. 308, 326 (DDC 1991).

Less Restrictive Alternatives

38. Because restrictions on the ability of any firm to enter new markets should be avoided whenever possible under the very principles that competition policy seeks to achieve, it is useful to consider whether there is some less restrictive alternative to the ban on telephone-cable cross-ownership that achieves similar protection for competition. For the reasons given below, I believe that there is not.

39. There are two candidates for the role of less restrictive alternative. First, either the antitrust authorities or regulators can deal with problems of cross-subsidy, discrimination and the like on a case-by-case basis, seeking to impose appropriate sanctions when such behavior is discovered. For the very reasons given above, however, this approach is likely to be extremely ineffective. Regulated utilities in general and telephone companies in particular have an enormous advantage over regulators, an advantage attributable to their control over information about costs and technologies. Judge Greene found that regulators in fact were unable to control AT&T's anti-competitive behavior. Moreover, as indicated above, the Bell Regional operating companies have continued since divestiture to engage in cross-subsidies and other anticompetitive behavior despite regulatory and antitrust oversight, and in spite of the fact that their incursions into related competitive activities have been severely curtailed by the Consent Decree in *Western Electric*. It would not be reasonable or economical of judicial resources, nor would it likely be effective in preventing anticompetitive abuses, to require repeated case-by-case enforcement of antitrust laws against so pervasive and likely a pattern of conduct.

40. Second, there are quasi-structural approaches such as that of the "fully separated subsidary". The idea here is to permit monopoly utilities to enter competitive businesses, while minimizing the regulator's difficulties in monitoring anti-competitive behavior by requiring that all the facilities, operations, personnel, books and records of the two activities be kept wholly separated. This approach might be successful in dealing with extensions to businesses that do not require the use of common facilities or vertical transactions with local telephone service, but it cannot work with respect to

telephone company provision of video programming services. Indeed, in two efforts to settle the antitrust case that led to the breakup of the old Bell System, the government and AT&T negotiated what became known as "Quagmire I" and "Quagmire II," in which attempts were made to specify all the behavioral and institutional safeguards that would be necessary to preserve competition if AT&T were to remain a combination of regulated local monopolies and competitive equipment and long distance businesses. These attempts failed because both parties realized that the concept was unworkable. B. G. Cole, ed., After the Breakup: Assessing the New Post-AT&T Divestiture Era, 8, 22, 37 (1991).

41. No amount of accounting separation combined with regulation and monitoring can deal effectively with the issue of common facilities and common costs that would exist if telephone companies provided video service in their own service areas. As indicated above, plaintiffs intend to offer competitive video transmission services and monopoly telephone services over common facilities. Plaintiffs do not plan to separate these transmission services from each other through separate subsidiaries nor could they. Therefore, separate subsidiaries offer no protection from anticompetitive cross-subsidization which would result in telephone company monopolization of video transmission services.

42. Another intractable problem with respect to cross subsidization by telephone companies of video programming services is improper allocation of the costs of financal risk-taking. As Professor Brennan has put it,

> Raising capital through borrowing may be a source of cross-subsidy. The regulator may

have a difficult time distinguishing whether the borrowing done was for the regulated product or another product. The regulated firm may be able to raise funds for ventures in other markets by borrowing against the assets of the regulated business. If the risk inherent in the regulated market is lower than that in the unregulated market, as might be expected given the residual unexploited demand created by regulation holding down price, this will result in subsidized lower-cost debt for the unregulated operations. The "subsidy" will be paid by increases in risk of the capital borrowed to pay for the regulated service, because that capital now bears some of the risk of the unregulated service. Brennan, *Why Regulated Firms Should Not Be Allowed in Unregulated Markets: Understanding the Divestiture in* U.S. V AT&T, 32 Antitrust Bull. 741, 763 (1987).

43. Nor would separate subsidiaries deal satisfactorily with discrimination issues. Having monopolized video transmission services, a telephone company would still have incentives to favor its video packager "subsidiary" in granting access to its monopoly transmission networks. The history of competitive abuses by AT&T involved exactly the same issues of discrimination in favor of AT&T's "separate" subsidiaries, Long Lines (AT&T's interexchange subsidiary) and Western Electric (AT&T's manufacturing subsidiary). Despite regulatory attempts to curtail these anticompetitive abuses, only divestiture and isolation of the monopoly local telephone companies from these related competitive activities was sufficent to eliminate them.

44. Finally, separate subsidiaries could not protect against "self-dealing" that could artificially raise video pro-

gramming costs. One strategy available to an integrated telephone company providing video programming services is to produce or have produced for it programming that it does not sell to other distributors. This was one strategy AT&T employed with Western Electric in selling exclusively to its affiliated local telephone companies equipment at inflated prices. Indeed, Plaintiffs are contemplating such exclusive programming for their Alexandria system. Horner Affidavit at ¶ 5. With no market transactions available to test the reasonableness of the prices charged for that programming, separate subsidiaries offer no protection from the evasion of regulation through the payment of excessive prices to unregulated program production affiliates.

Cable Monopolies

45. The Plaintiffs in this matter assert with vigor that cable television companies are monopolists, and that the national policy in favor of competition would be advanced by permitting the entry of telephone companies. Hazlett Affidavit at ¶¶ 30-31. There is no doubt that cable television companies have market power. But so do many firms in the economy; market power is a matter of degree. *Schurz Communications, Inc. v. F.C.C.*, 982 F.2d 1043 (7th Cir. 1992) at 1052.

46. Plaintiffs' argument is wrong-headed even if cable systems are monopolists. Competition is indeed promoted when barriers to entry are reduced. But competition is not promoted when regulated monopolists are permitted to leverage their economic power from one market to another, regardless of the structure of the secondary market. A I have noted above, such leveraging in the end generally harms consumers in *both* markets. The wisdom of excluding tele-

phone companies from the video programming business must be assessed independently of whether cable television companies are presently in possession of market power. In any event, actual and potential technologies such as direct broadcast satellites and wireless cable present far more immediate and legitimate competitive threats to the cable industry than telephone technologies. The special threat of telephone entrants is the ability, not necessarily to provide a superior service, but to engage in profitable long-term predation and discrimination, regardless of the quality of their service.

Future Considerations

47. In the future, conditions may change sufficiently to warrant removal of the prohibition of telephone company ownership of cable television systems. The market for local telephone service is beginning to face emerging competition for some business customers because of bypass, cellular, fiber optic ring, and other new technologies. DBS or other new developments may make it impossible for local telephone companies to monopolize transmission. It is important that the restriction on telephone provision of video services be kept in place, however, to ensure that the trend toward greater competition for local telephone services is not reversed. Significantly, the nascent competition that faces telephone companies is concentrated in their services to business customers. Cable probably is the only serious source of potential competition for residential telephone service; as I have noted above, the reverse is not true. It would be unwise economically to risk eliminating that potential threat by exposing cable television competitors today to anticompetitive behavior by local telephone companies. In the future, when it is possible to conclude with a reasonable degree of

confidence that the trend toward competition for local telephone services cannot be reversed by anti-competitive behavior on the part of local telephone companies, removal of the prohibition would be appropriate.

/s/ Bruce M. Owen
BRUCE M. OWEN

[Notarization Omitted in Printing]

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Virginia)

[Caption Omitted in Printing]

REPLY AFFIDAVIT OF ALFRED E. KAHN

STATE OF NEW YORK

COUNTY OF TOMPKINS

(1) My name is Alfred E. Kahn. I am Robert Julius Thorne Professor of Political Economy, Emeritus, at Cornell University and Special Consultant to National Economic Research Associates, Inc. My business address is 308 North Cayuga Street, Ithaca, New York 14850.

(2) Among the experiences of mine pertinent to my submission in this proceeding are that I was Chairman of the New York State Public Service Commission between 1974 and 1977 and of the Civil Aeronautics Board in 1977-78; I am the author of the two-volume *The Economics of Regulation*, published originally by John Wiley & Sons in 1970 and 1971 and reprinted in 1988 by The MIT Press; I have written and testified extensively on the subject of telecommunications regulatory policy and published a book and numerous articles on antitrust policy. I was a member of the Attorney General's National Committee to Study the Antitrust Laws and the National Commission for the Review of Antitrust Laws and Procedures. I have been advisor on telecommunications policy to Governor Carey, of New York State, recently completed service as a member of the Ohio Blue Ribbon Panel on Telecommunications Regulatory Reform, and am at present a member of the New York State Tele-

communications Exchange. I attach a copy of my full resumé as an Appendix to this affidavit.

(3) The purpose of my affidavit is to appraise and respond to the government's proffered justification for the ban against the plaintiffs providing their video programming to the public within their telephone service areas—namely, that the prohibition is necessary to prevent the telephone companies from "cross-subsidizing" cable operations with revenues from their monopoly telephone operations. The result of such a cross-subsidy, the government contends, would be that the cable companies could or would be driven out of business, leaving the telephone company as the monopoly provider of both cable and telephone services.

(4) This contention of the government of the likely—or even possible—effects of a lifting of the ban rests on a number of key premises. The most important of these are that authorization of the telephone companies or their affiliates to create or assemble video programming for sale to the public, in addition to their present ability to carry the signal of others, would materially increase the asserted danger of cross-subsidization; that regulators would freely permit the recoupment from politically-sensitive services such as basic local residential service, of costs that could or should have been assigned to video; and that the telephone companies would, as a result, be able to drive their cable competitors from the market. All of these beliefs are in my opinion erroneous.

(5) The asserted danger of cross-subsidization, as described by both the Department of Justice and the NCTA, arises almost exclusively from the fact that the telephone network is evolving into a facility capable of carrying voice, data and video images. Cable systems too are developing these same capabilities. This kind of joint or common use is not an evil in itself: on the contrary, it is a source of efficiency—a clear exemplification of what economists refer to as economies of scope. It does

increase the importance of the issue, particularly in a regulated industry, of how the common costs are to be distributed among those several services. This is not a new regulatory problem in telephony: regulators have long ago developed methods of separating the costs of telephone service subject respectively to state and to federal regulation. They have also devised and prescribed methods of assigning or allocating joint and common costs among the various individual services subject to their respective jurisdictions. Intervenors have the right to contest these methods in regulatory proceedings and rights of appeal if they are not satisfied with the agency's determinations.

(6) As the foregoing discussion makes clear, the danger of cross-subsidization typically arises in situations in which significant portions of the costs of competitive and monopoly services are common to both. If some of these costs are improperly shifted from the former to the latter and recovered in the charges for the monopoly services, this could indeed confer an unfair advantage on the telephone company in its competitive markets, and could conceivably enable it to drive its competitors out of business. The question is whether this hypothetical scenario fits the facts and the probabilities associated with the legal issue now before this Court. I conclude emphatically that it does not.

(7) First, it cannot be overemphasized that what is at issue in this case is the plaintiffs' authority to engage in video programming, not their already acknowledged authority to provide video transmission. It is difficult to conceive that there could be any substantial costs common to the transmission of video and other telephone signals, on the one side, and the creation and packaging of video programming on the other. Numerous authorities, including the defendants, have actually conceded this fact. For example, NCTA, through economist Dr. Owen, admits that the defendants' cross-subsidy scenario requires

the presence of common costs[1] and that there are no substantial costs common to both video transport and programming.[2] And the Department of Justice has conceded elsewhere that "information services that involve primarily the provision of content or the processing of information . . . would be likely to share fewer facilities or personnel with [telephone company] local exchange operations [than transmission services]. . . . [T]he potential for misallocation of costs in violation of allocation regulations is minimal and even more easily detected by regulators where there is a relative paucity of joint and common costs between telephone exchange operations and ventures in the new market."[3] The statutory ban at issue here applies not to a service that, in the words of the Department, involves "*primarily* the . . . content of information"; it applies to a service that involves *only* content. There is therefore no rational connection between the defendants' cross-subsidy argument and the ban against telephone companies providing video *programming*.

(8) In the interest of a complete response, however, I have considered whether, if the prohibition at issue here is lifted, the telephone companies might, as Dr. Owen contends, be in a position somehow to cross-subsidize their video transmission services at the expense of other, monopoly services. In my view this is highly unlikely—unlikely that they would be permitted, and even if per-

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[1] *E.g.*, Owen Aff. at 15.

[2] *E.g.*, Owen Aff. at 4 ("there are no obvious economies of scope or of vertical integration arising from both laying fiber optic cable and producing or buying and then packaging video programming"); *see also* NCTA Mem. 23, *United States v. Western Elec. Co.* (D.D.C. filed Oct. 17, 1990), ("it may well be, as the Huber Report says, that opportunities for cross-subsidization may be few in the creation of programming").

[3] Mem. of the United States at 34, *United States v. Western Electric Co., Inc.*, (D.D.C. filed Aug. 22, 1990).

mitted, able to do so. As for the first, I am advised by counsel that video transmission services are subject to federal, not state regulation. The principal other services subject to that jurisdiction are the "access" to or interconnection with the local exchange network that telephone companies provide to long distance carriers such as AT&T for the origination and termination of long distance calls. The FCC's method of regulating these charges does not automatically permit raising them whenever the providers' overall earnings decline; and its cost allocation rules, to which I have already referred, prohibit that kind of cross-subsidization.

(9) As to the *ability* of the telephone companies to raise their rates for these access services, these charges constitute approximately 40% of the long distance carriers' total operating costs. Entirely apart, then, from whether the FCC would *permit* the requisite increase, the resistance on the part of the customers would be intense, and effective. These are very sophisticated carriers, with every incentive to avoid improper cost shifting to their injury. And they have the protection, increasingly, of competition, and will have it even more in the future, as alternative providers of access services have emerged to handle the origination and termination of long-distance traffic, particularly of large governmental and business installations. The recently announced multi-billion dollar TimeWarner/US West transaction is premised on the fact that cable systems, which now reach 96 percent of all households, can be modified to provide this same access service, in competition with local telephone companies, for small as well as large customers. MCI, similarly, has announced its engagement in active negotiations with cable companies, with the same purpose in mind. For these many reasons I conclude that there is no significant danger of successful cross-subsidization even of video transmission by telephone services—whether or not the telephone companies are permitted to engage in video programming.

(10) Recovery of any such subsidies at the intrastate or local level is similarly highly unlikely, and becoming increasingly so every day. Entirely apart from the question of the willingness of state regulators to permit it, local service is becoming increasingly competitive. NCTA itself describes the cable industry as a "serious source of potential competition for residential telephone service." [4] Furthermore, the divestiture of AT&T has spawned a host of actual and potential competitors previously all part of that single corporate entity. Southwestern Bell, for example, has acquired cable systems in the Washington area, including Northern Virginia, which position it to provide not just video but competitive access services of the type contemplated also by the U.S. West/Time Warner transaction. Southwestern Bell also provides wireless services in this area. AT&T has already purchased a multi-billion dollar stake in wireless services competitive or potentially competitive with the incumbent local telephone companies; and the trade journals report that MCI likewise intends to enter the local exchange business with wireless technology. The FCC is actively promoting expansion of this competition—for example, by allocating additional spectrum to new wireless services and requiring the telephone companies to provide interconnection with all competitive access providers.

(11) At least equally important, state regulators have historically been very reluctant to raise residential telephone rates, for obvious political reasons. Consequently, even if the costs of video programming could be misassigned to transmission services, and misassigned again over the federal-state jurisdictional boundary to local exchange services, it is certain that the regulators would resist the requisite compensatory price increases. If the state regulatory commissions may be said to have had one overriding goal historically, it has been to hold down the price of basic residential telephone service; and they have done so

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[4] Owen Aff. at 31.

to the point of holding those prices inefficiently low and requiring inefficiently high charges for "vertical" or "enhanced" services. Far from permitting cross-subsidization of competitive by monopoly services, regulators have typically handicapped telephone companies in the competitive markets—inefficiently so.

(12) As the defendants themselves point out,[5] the cross-subsidization they predict is possible only to the extent a telephone company's services are subject to cost-based, rate-of-return regulation. The kind of recoupment they posit was never automatic, even under that traditional regulatory practice: rates were altered only periodically and raised only when achieved rates of return fell outside an acceptable range.

(13) In both 1970, when the FCC first adopted the prohibition at issue here, and 1984, when Congress enacted it, telephone companies were in fact universally subject to traditional rate-of-return regulation. Today, in contrast, the FCC and a majority of state regulators have substantially modified that form of regulation in favor of price freezes or caps, which fix the *price* of services rather than telephone company *profits*, or other "incentive" regulatory arrangements that permit company profits to fluctuate within a wider than traditionally permitted range, with or without automatic sharing with ratepayers of profit surpluses or deficiencies. All of these plans, by further weakening any previous assurances of automatic recovery from less competitive services of net revenue losses from competitive ones, have the effect of weakening any incentive or ability the telephone companies may previously have had to cross-subsidize competitive services at the expense of others less subject to competition. Indeed, prevention of cross-subsidy has been one central, explicit reason for the adoption of these reforms. The very fact that it is the telephone companies themselves that have been the principal proponents of these plans further contradicts

[5] *E.g.*, Owens [*sic*] Aff. at 15.

the defendants' contentions that they would respond to removal of prohibitions on their entering various competitive businesses with a strategy of cross-subsidy. Under the various forms of incentive regulation, the incurrence of "losses" on competitive business would simply decrease their profits. Significantly, even NCTA concedes that a pure price cap arrangement would "reduce or eliminate the incentive to shift costs to regulated services." [6]

(14) There are some respects in which the arguments of the defendants do not rest entirely on the presence of common costs, on the one side, and of the opportunity to recover the burdens of cross-subsidy via cost-plus regulation on the other. For example, one of the amici on the side of the cable industry argues that the telephone companies would have an unfair advantage by virtue of their ability to "cherry pick personnel" from their telephone operations for the benefit of their video programming services.[7] But, as the DC Circuit has observed with admirable conciseness, "[r]unning a local [telephone] exchange does not require reporters, copy editors, joke writers, financial analysts, astrologists, or other information-content providers" [8]—to which list one might add screen writers, Hollywood stars and game show hosts.

(15) Dr. Owen's affidavit on behalf of NCTA also cites, as an asserted unfair advantage of telephone companies, their ability to raise capital for the combined enterprise on more favorable terms than their cable competitors. First of all, the opinion he expresses that the overall cost of capital of well-managed cable companies is higher than of telephone companies is a mere undocumented assertion on his part. In any event, the sufficient response

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[6] Owen Aff. at 23.

[7] Brief of Amici Curiae Consumer Federation of America, *et al.*, at 22 (dated May 21, 1993).

[8] United States v. Western Electric Co., 900 F. 2d 283, 308 n. 28 (D.C. Cir. 1990).

is that nowhere in the economist's conception of the prerequisites of effective competition or in the antitrust laws, to my knowledge, has the mere possible ability of one company to raise capital on more favorable terms than another been regarded as providing a sufficient basis for excluding that company from the opportunity to compete with others putatively less advantageously situated in that respect.

(16) Finally, Dr. Owen's asserted concern that a telephone company could engage in "self dealing" by paying a programming affiliate inflated prices for its programming has the facts completely backwards. It is not the telephone company that proposes here to purchase programming from an affiliate. It is the programming affiliate that would buy video transport service from the telephone company, at tariffed rates. And of course the affiliate would have every incentive to produce and acquire programming as economically as possible, since it would be in the business of offering it to subscribers, for whose patronage it would be competing with the cable companies.

(17) Finally, I find the ultimate essential component of the successful strategy of cross-subsidy and predation hypothesized by the defendants in this proceeding—namely the permanent removal of competitors—highly improbable in the present circumstances. The cable companies have installed networks capable of serving 96% of all households. That capacity is not going to go away. The marginal cost of operating these systems must be relatively low, leaving their operators with latitude for price reductions more than sufficient to discourage any would-be predator. It is the cable companies that are the dominant incumbents in the video entertainment market, with access or contractual rights to the most popular entertainers and shows. Their facilities also have the potential to be upgraded to provide two-way communications services, which could produce an enormous supplemental revenue stream. In the circumstances I find it simply inconceivable that they will or could be driven out of business by the mis-

assignment of the costs of telephone company video services.

CONCLUSION

There is no economic basis for the expectation that permitting the telephone companies to provide video programming directly to the public within their service areas would put them in a position to deny the cable companies a fair opportunity to compete or, through cross-subsidization, to drive them from the market.

/s/ Alfred E. Kahn
ALFRED E. KAHN

[Notarization Omitted in Printing]

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

[Caption Omitted in Printing]

AFFIDAVIT OF PATRICIA S. TICER

COMMONWEALTH OF VIRGINIA)
) to wit:
CITY OF ALEXANDRIA)

Patricia S. Ticer, being duly sworn, deposes and says as follows:

1. I am the Mayor of the City of Alexandria, Virginia, and have held that position since 1991. Prior to that, I served as a member of the City Council for 8 years.

2. On June 26, 1991, I testified before The United States House of Representatives, Committee on Energy and Commerce Subcommittee on Telecommunications and Finance, on behalf of the National League of Cities and the United States Conference of Mayors with respect to telephone company provision of cable television services. I testified in favor of telephone company entry into the cable market subject to appropriate regulatory safeguards. I continue to believe that competition provided by telephone companies is in the public interest and, specifically, in the best interests of the residents of the City of Alexandria.

3. If the prohibition contained in Section 533(b) of the 1984 Cable Act were removed, and the Chesapeake and Potomac Telephone Company of Virginia and Bell Atlantic Video Services Company were to make application for a franchise pursuant to Title 9, Chapter 3 of

the Alexandria City Code, the application would be acted upon by the Alexandria City Council, and would receive the same consideration as the application of any other applicant.

/s/ Patricia S. Ticer
PATRICIA S. TICER

[Notarization Omitted in Printing]

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

[Caption Omitted in Printing]

AFFIDAVIT OF JEAN POOL

1. I am Senior Vice President, Director of Local Market Broadcast for J. Walter Thompson. I manage a negotiating unit comprised of 136 specialists located in seven major markets across the U.S. We purchase commercial airtime on radio, television, and local cable systems on behalf of J. Walter Thompson clients including Bell Atlantic. I am knowledgeable about the practices of the cable industry with respect to the selling of airtime.

2. On May 25, 1993, we made an inquiry to Jones Intercable to determine whether it would be possible to lease a channel on its cable system in Alexandria, Virginia. Jones said it has no channels available for leased access in Alexandria. Jones, however, will lease time slots, subject to availability, in half hour increments.

3. Jones Intercable, as is the case with all other local cable companies, reserves the right to view proposed programming prior to air. This is typically how all broadcast stations operate also.

4. Based on my experience buying time on cable systems, I believe that Bell Atlantic would be unlikely in most communities to be able to lease even one channel from the local cable operator. Cable systems typically are already filled to capacity with programming and are unwilling to bump existing programs to make room for leased access users. In most instances, therefore, Bell Atlantic would be limited to leasing short, individual

time slots subject to availability and subject to the editorial preview of the cable operator.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on 6-2-93.

/s/ Jean Pool
JEAN POOL

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

[Caption Omitted in Printing]

AFFIDAVIT OF ROBERT L. TOWNSEND

1. My title is Director of Bell Atlantic Video Services Company ("BVS"). I have worked in the cable TV Industry for over a decade. Before joining BVS, from 1989 to 1992, I was Senior Vice President of a subsidiary of the Home Shopping Network, which is a producer of video programming sold to cable systems. Prior to that, from 1981 to 1989, I was Vice President, Sales, Marketing, and Programming of New York Times Cable TV. In addition, I have served as a member of the board of directors of the Cable Television Administration and Marketing Society ("CTAM") and was President of the Northeast Region of CTAM. I have substantial experience—from the perspectives of both a cable operator and an independent video programmer—in buying and selling video programming.

2. I submit this affidavit in response to the government's claim that the prohibition in this case does not "unduly burden" BVS's ability to provide video programming in its telephone affiliates' service areas. Gov't Mem. 66.

3. The government claims that, despite the prohibition, BVS could sell programming to existing television networks and could acquire a local television broadcasting station. Gov't Mem. 66. The Newspaper Association, unlike the government, claims that BVS could acquire broadcast stations only outside its telephone affiliates'

service areas. NAA Mem. 12. On the other hand, the Newspaper Association claims that BVS could lease channel capacity from existing cable operators. NAA Mem. 11. The NCTA claims that BVS could offer programming to existing broadcast television stations, cable operators, movie theaters, or video stores. NCTA Mem. 56. The National Association of Broadcasters claims that BVS is barred from all in-region video programming. NAB Mem. 32. Despite the differences in these parties' views regarding what is permitted, they all—except for the broadcasters—suggest that there exist ample alternative means for BVS to distribute its video programming even within its telephone affiliates' service areas.

4. Assuming for purposes of this affidavit that the proposed alternatives are all legally permitted, they in fact do not provide BVS a meaningful opportunity to provide video programming of the type and in the quantity that it seeks to provide. The problems with these alternatives are discussed below.

5. Many of the alternatives would subject BVS's programming to the editorial discretion of the existing program distributors. Cable operators and television broadcast stations have no obligation to purchase BVS's programming. BVS's ability to get its programming shown in any particular geographic area would be entirely subject to the whim of cable companies and broadcasters.

6. NCTA states that BVS could simply create and market the "Bell Atlantic Hour" for carriage on local cable systems. NCTA Mem. 56. NCTA chose this example very carefully. As described in Jean Pool's affidavit, the "Bell Atlantic Hour" is near the maximum amount of air time that a typical cable system will sell to an independent programmer. But even shorter time slots can be difficult to arrange if the content of the programming is disagreeable to the cable operator. In November 1991, one of Bell Atlantic's companies, New Jersey Bell, produced a 30-second commercial advertisement

regarding a bill pending before the New Jersey legislature. Suburban Cable, a large cable operator in Northern New Jersey which opposed the bill, initially refused to carry the commercial. After a period of negotiation, Suburban Cable agreed to carry the commercial but insisted on running its own commercial immediately afterward responding to New Jersey Bell's commercial. The result was to confuse and adulterate the message New Jersey Bell was trying to present. In a subsequent complaint proceeding before the New Jersey Board of Regulatory Commissioners, Suburban Cable defended its actions as "editorial discretion." Answer to Petition at 3, BRC Docket No. CC91121783 (Dec. 20, 1991).

7. Suburban's standard term sheet (copy attached) provides that "Suburban Cablevision shall have the right to approve or disapprove all materials submitted for cablecasts" and that its "right of disapproval shall be exercised in its sole discretion as to any matter it deems objectionable for any reason whatsoever." Suburban's term sheet is typical. The standard term sheet (copy attached) currently in use by Mega Advertising, which arranges airtime on behalf of cable systems in the Washington, D.C. metropolitan area, provides that "[a]ll programs" are subject to "prior approval." Programs will not be aired if, in Mega Advertising's "sole discretion," they are "determined to be unsatisfactory, unsuitable or contrary to the public interest."

8. None of the proposed alternatives would permit BVS to provide more than a channel or two of programming. For example, buying a local broadcast television station, as the government suggests, would allow BVS to program one channel. Most cable operators today offer 30 to 53 channels. BVS's programming plan for Alexandria includes approximately 100 channels. To fit within the alternatives, BVS would have to abandon 99% of its programming plan.

9. Moreover, relegating BVS to begging and borrowing space from the existing program distributors would

not promote programming diversity. Rather it would ensure that there is no net increase in the amount of programming. Whatever programming BVS would show would simply displace other programming.

10. None of the alternatives would permit BVS to offer video on demand service. This service requires the technical ability to address individual subscribers and to deliver to subscribers specific programs that they order. This service also requires a return communication capability so that the subscriber can select a video, pause it, restart it, and perform other functions to interact with the video. To my knowledge, there is no cable system or broadcast station in the Bell Atlantic region that employs the type of technology needed for this service. Requiring BVS to provide programming over the existing media, therefore, has the effect of barring this new service.

11. Video on demand is qualitatively a different type of programming than traditional broadcast or cable. From the customer's perspective, video programming that a broadcaster or cable operator has pre-selected is not a substitute for programming that the customer selects herself.

12. Finally, the Newspaper Association's suggestion that BVS lease channels from existing cable operators is not a viable alternative. Leased access has been available since 1984, but programmers have made "scant use of the leased access channels." *Report and Order, In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation*, MM Docket 92-266, at 318 (released May 3, 1993). There have been severe problems with leased access arrangements. Among other things, cable operators charged high rates, subjected programmers to the cable operators' editorial control, and provided no mechanism for billing subscribers on behalf of the leased access programmers. The House Report ac-

companying the 1992 Cable Act concluded that "leased access has not been an effective mechanism for securing access for programmers to the cable infrastructure or cable subscribers." H. Rep. No. 102-628 at 39. Pursuant to the 1992 Cable Act, the FCC recently issued rules attempting to rectify some of the deficiencies in leased access. However, the FCC cautioned that its rules are to be "understood as a starting point that will need refinement." *Report and Order*, MM Docket 92-266, at 306 (released May 3, 1993). Time Warner has filed a First Amendment challenge to the leased access requirements on the ground that they would interfere with its "editorial discretion." Complaint for Declaratory and Injunctive Relief at 44-45, *Time Warner Entertainment Co. v. FCC*, No. 92-2494, (D.D.C. filed Nov. 5, 1992).

13. In any event, leased access would allow only a small amount of programming. A cable system the size of Jones's system in Alexandria would be required to make available a total of four channels. If multiple programmers seek access to these channels, under the FCC's rules BVS "will only be allowed to lease up to one channel's capacity." *Report and Order*, MM Docket 92-266, at 310 (released May 3, 1993). Leased access, therefore, involves most of the problems of the other alternatives.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on 6/3/93.

/s/ Robert L. Townsend
ROBERT L. TOWNSEND

SUBURBAN CABLEVISION TERMS AND CONDITIONS

GENERAL TERMS AND CONDITIONS

Agency and client are both jointly and separately responsible for all terms and conditions of this contract.

* * * * *

Cablecast Approval

Suburban Cablevision shall have the right to approve or disapprove all material submitted for cablecasts hereunder and to refuse to permit any individual to participate in any cablecast. Suburban Cablevision's right of disapproval shall be exercised in its sole discretion as to any matter it deems objectionable for any reason whatsoever. The Advertiser/Client should submit any questionable matter to Suburban Cablevision for a determination of the permissibility of its use before contracting any obligations or commitments in connection therewith.

All programs and production material remain the property of Suburban Cablevision unless exempted in this agreement.

* * * * *

CONDITIONS

The advertiser and its agency, if any, (collectively, "ADVERTISER") purchasing broadcast time for the announcements or programs provided for in this contract and such talent as is specified herein. Mega Advertising hereby agrees that this contract shall be governed by the following terms and conditions:

* * * * *

5. PROGRAMS AND COMMERCIAL MATERIALS

* * * * *

(b) All programs or announcements to be broadcast are subject to the prior approval of Mega Advertising,

and Mega Advertising without restriction or liability reserves the right to refuse to broadcast any program or announcement that Mega Advertising, in its sole discretion, determined to be unsatisfactory, unsuitable or contrary to the public interest.

* * * * *

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

[Caption Omitted in Printing]

SUPPLEMENTAL AFFIDAVIT OF WILLIAM E. LEE

1. In my affidavit of April 27, 1993 I demonstrated that the creation, selection, arrangement, packaging, and provision of video programming for multichannel delivery, whether performed by a cable company or by Bell Atlantic Video Services ("BVS"), involves editorial decisions that are functionally indistinguishable from those involved in newspaper editing. None of the parties challenging the plaintiffs' motion for summary judgment have disputed that point. However, they have sought to distinguish telephone companies from newspapers, suggesting newspaper do not receive government-bestowed benefits as telephone companies do. In this supplemental affidavit, I briefly describe the extensive and valuable benefits conferred upon newspapers by federal, state, and local governments.

2. In its Memorandum, the United States claims that the plaintiffs depend upon federal and state government for acquisition and maintenance of their monopoly of local telephone service. Mem. of United States at 44. *See also* Mem. of NCTA at 4 & 43 (local telephone companies are the recipient of a valuable government grant). The United States also claims that the plaintiffs depend upon government for use of rights-of-way. Mem. of United States at 60. The United States argues that the print medium "has never enjoyed any remotely similar set of government-bestowed benefits." *Id.* at 44 n.41. In their brief, the Newspaper Association of America and the Virginia Press Association make similar claims concerning government-conferred monopoly status, but

add that telephone companies use the electromagnetic spectrum as well as public rights-of-way. Brief Amici Curiae of NAA and VPA at 23-24.

3. Among the benefits conferred upon newspapers by the government are the following:

a. Competition between separately owned local daily newspapers is exceedingly rare. In 1992, daily newspapers were published in 1,513 U.S. cities. Only 37 cities had two or more separately owned, competing dailies; 19 of these cities had newspapers published under joint-operating agreements which allow papers to merge activities such as advertising and printing. Newspaper Association of America, *Facts About Newspapers 92* at 26 (1992). In *Citizen Publishing Co. v. United States*, 394 U.S. 131 (1969), a joint-operating agreement was found to be a violation of the antitrust laws because it involved price fixing and profit pooling, and restricted entry into the market. Congress responded by conferring upon the newspaper industry one of the few limited exemptions from the antitrust laws. The Newspaper Preservation Act, 15 U.S.C. §§ 1801-1804, permits newspapers that maintain separate editorial staffs to combine their printing, distribution, advertising, circulation, and business departments. The joint-operating agreements authorized by the Act eliminate advertising competition among the jointly operated papers, and create cost savings that place actual and potential competitors at a marked disadvantage. Many commentators have criticized the Act as being anticompetitive. *See, e.g.*, Flynn, *Antitrust and the Newspapers: A Comment on S. 1312*, 22 Vand. L. Rev. 103 (1968); Knox, *Antitrust Exemptions for Newspapers: An Economic Analysis*, 1971 Law & Soc. Ord. 3; Comment, *The Newspaper Preservation Act*, 32 U. Pitt. L. Rev. 347 (1971). As the Court of Appeals for the Ninth Circuit wrote, Congress was aware of the Act's anticompetitive effects, but made a policy determination that other considerations, such as preserving editorial di-

versity, were paramount. *Committee for an Independent P-I v. Hearst Corp.*, 704 F.2d 467, 481-82 (9th Cir. 1983).

b. Newspapers receive preferential rates and expedited delivery from the United States Postal Service. *See* United States Postal Service, *Domestic Mail Manual* at 371-491 (1992) (discussing second-class mail policies and procedures). This preferential treatment, designed to encourage the circulation of newspapers, originated with Benjamin Franklin and has continued to the present. *See generally* W. Fuller, *The American Mail: Enlarger of the Common Life* at 122-27 (1972) (discussing 19th century postal laws favoring newspapers). Prior to the reorganization of the Post Office in 1970, rates for mail delivery of newspapers were heavily subsidized; second-class mail contributed only 3% of postal revenues but accounted for 11% of total postal volume. G. Cullinan, *The Post Office Department* at 240 (1968). The amount of the subsidy has been reduced as the reorganized Postal Service attempts to become self-supporting, but Congress continues to appropriate funds to subsidize second-class mail. Rambo, "Newspaper and the Postal Service," *Presstime*, Jan. 1986, at 20.

c. The importation of newsprint is duty-free. United States International Trade Commission, *Supplement 1 to the Harmonized Tariff Schedule of the United States* at 48-5 (1992). The absence of a duty significantly benefits newspaper publishers for two reasons. First, American newspapers import as much as 60% of the newsprint they use, primarily from Canada. Deutsch, "Bags and Boxes Full of Profits," *New York Times*, Aug. 14, 1988, at sec. 3, p. 1. Second, newsprint accounts for as much as 33% of the cost of publishing a daily newspaper. C. Fink, *Strategic Newspaper Management* at 78 (1988). This is second only to labor in publishing expenses. *Id.* at 77-78; J. Udell, *The Economics of the American Newspaper* at 118-24 (1978).

d. Newspaper employees involved in delivery are exempt from certain provisions of the Fair Labor Standards Act, 29 U.S.C. § 213 (d). State labor laws also exempt newspaper carriers from collective bargaining, and minimum-wage and age requirements. *See, e.g.*, West's Rev. Code Wash. Ann. § 49.46.010(f) (Supp. 1986); Pa. Stat. Ann. tit. 43 § 33.105(3) (Purdon Supp. 1985); Mass. Ann. Laws ch. 49 § 69 (Michie/Law Co-op. 1976). Although the percentage of youth newspaper carriers has been declining in recent years, in 1992, youth carriers constituted 65.7% of total U.S. daily carriers. Newspaper Association of America, *Facts About Newspapers 92* at 25 (1992).

e. Newspapers are extensive users of the FCC-regulated spectrum. First, newspapers today receive information via communications satellites. This information includes news stories, photographs, and graphics from services such as the Associated Press, United Press International, and Reuters. Bacon, "Satellites Make Big Impact at Newspapers," *Presstime*, Aug. 1988, at 6. The use of communications satellites has also fostered the growth of supplemental news services such as Scripps Howard News Service, Los Angeles Times-Washington Post News Service, New York Times News Service, and Knight-Ridder/Tribune News Information Service. W. Agee, P. Ault & E. Emery, *Introduction to Mass Communications* at 148 (10th ed. 1991). Additionally newspapers receive national advertisements via satellite from the AD/SAT company. *Id.* at 430. Second, newspapers send finshed pages to printing plants via terrestial microwave links or communications satellites. For example, the *Washington Post* sends pages to printing plants in the District of Columbia and Springfield, Virginia via microwave; the *New York Times* links its New York offices with a printing plant in Edison, New Jersey via satellite. National newspapers, such as the *Wall Street Journal, Christian Science Monitor, USA Today,*

and the *New York Times* national edition, send pages to printing plants, throughout the country via satellite. *See, e.g.* "Nationalizing the New York Times," *Editor & Publisher,* Jan. 21, 1984, at 36-37 (describing the technology used in satellite transmission of newspaper pages). Third, newspapers are experimenting with use of the spectrum to reach the consumer. For example, Knight-Ridder, one of the nation's largest newspaper chains, is developing a hand-held notebook computer designed to receive newspaper content via satellite. Reilly, "Publishers Design Electronic Newspapers to Keep Control of Information Delivery," *Wall Street Journal,* Feb. 26, 1993, at B1.

f. Most states exempt newspapers from sales tax. A 1986 study of newspaper taxation found only 12 states imposing taxes on newspaper circulation. "Six States Now Tax Some Form of Advertising, but the Number Taxing Newsprint and Ink Declines," *Presstime,* Feb. 1986, at 42. Only two states tax the purchase of materials such as ink and newsprint used to produce newspapers. *Id.*

g. Some states have enacted retraction statutes providing special protection for newspapers in defamation actions. These statutes preclude the award of a class of damages, or mitigate damages. Three of the 33 states with retraction statutes apply this protection only to newspapers; 8 limit it to newspapers and periodicals; 14 cover both print and broadcast media, and 8 cover any defendant. R. Sack, *Libel, Slander, and Related Problems* at 379 (1980).

h. Newsracks are often placed on city property such as sidewalks and the United States Supreme Court recently noted the importance of this form of distribution. *City of Cincinnati v. Discovery Network, Inc.*, 61 U.S.L.W. 4272, 4273 n.10 (U.S. Mar. 24, 1993) ("almost half of the single copy sales of newspapers are now distributed through newsracks"). In general, newspaper

publishers do not pay municipalities a fee for placement of newsracks on public property.

4. As this affidavit reveals, the claim that the newspaper industry does not receive valuable and extensive benefits from the government is clearly false. Government-conferred benefits pervasively affect newspaper publishing on a daily basis and increase newspaper profitability.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on June 3, 1993.

/s/ Wm. E. Lee
WILLIAM E. LEE

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

[Caption Omitted in Printing]

AFFIDAVIT OF H. R. STALLARD

1. I am the President and Chief Executive Officer of The Chesapeake and Potomac Telephone Company of Virginia ("C&P"). I joined the company in 1959 as a Staff Assistant-Engineer and had various positions of increasing responsibility until I was appointed to my present position in 1988. This affidavit responds to several matters raised by the government, NCTA, and others who filed briefs opposing our provision of video programming.

2. *Rate regulation.* Bruce Owen's affidavit claims that "local telephone companies characteristically are subject to cost-based regulation." This was true in 1970, but the fact is that telephone regulation is moving away from cost-based formulas toward priced-based systems that reward companies if they reduce costs and penalize them if costs increase. C&P's interstate telephone services are subject to regulation known as "price caps." Under a formula established by the FCC, C&P's charges for interstate services may not exceed a specific "cap." Each year, the cap is adjusted by the actual amount of inflation minus a fixed downward adjustment of 3.3% for assumed productivity gains. The resulting formula ensures that prices decrease year after year in real, inflation-adjusted terms.

3. At the state level, C&P is currently regulated under an experimental regulatory plan effective in 1989

which incents the company to avoid rate increases altogether. Under this Plan, C&P has not increased its basic schedule of rates. In fact, C&P has not increased its rate schedules since January, 1984, and C&P has actually reduced rates significantly since that time. The State Corporation Commission is currently evaluating the effectiveness of its Experimental Plan and is considering modification to it. The Virginia General Assembly enacted legislation, effective July 1, 1993, that specifically empowers the Commission to adopt new forms of regulation which are not cost-based. (A copy of the legislation is included in plaintiffs' document appendix, vol. IV, tab 52.) The legislation requires that any new form of regulation provide safeguards to "assure that there is no cross subsidization of competitive services of a telephone company by monopoly services." C&P will ask the State Corporation Commission under this legislation to modify regulation in such a way that C&P's rates for basic service will be capped for a number of years and can be increased thereafter only at a fraction of the increase in the rate of inflation. We will specifically request that the Commission adopt this regulatory plan so as to decouple the relationship between prices of regulated basic services and their costs.

4. Owen and others claim that C&P will subsidize its Alexandria video transport network by raising rates. However, as I have stated, the curent [*sic*] regulatory environment in Virginia will not permit this to happen. Moreover, when C&P filed this lawsuit, it committed to the State Corporation Commission that it will not, in any event, seek to increase rates for basic telephone services as a result of its investment in Alexandria to enhance its telephone network to carry video. (See my letter of December 17, 1992, to the Commission and the December 21, 1992, response from Hon. Preston C. Shannon, attached.)

5. Owen's cross subsidy theory would also apply to other competitive services that C&P and its affiliates are permitted to provide. C&P and its affiliates provide a number of information services and a number of other services which are competitive with those offered by non-regulated or lightly-regulated firms. Yet, nowhere in the government's document submission nor in the submissions of the government's amici is there any allegation that C&P has engaged in cross subsidy. For example, the provision of access service from a customer's location to a long distance company's switch is increasingly competitive. But C&P is not increasing any of its basic service rate schedules to offset competitive losses or to subsidize competitive access services. In fact, basic rates have been stabilized or decreased.

6. *Transactions between C&P and BVS.* Owen claims that BVS intends to sell video programming to C&P. Such sales allegedly would allow C&P "to increase the apparent costs and therefore the permitted price of the regulated service." Owen claims that these sales will create "a substantial opportunity to engage in cross-subsidization." Owen, however has the facts backwards. BVS will not be selling programming to C&P; instead, C&P will be selling tariffed video transport to BVS as well as to other unaffiliated programmers on the same terms. BVS's programming will not be part of C&P's costs of regulated service.

7. The government claims that there are state law obstacles to C&P's provision of tariffed video transport services to BVS. C&P, however, currently provides tariffed services to various corporate affiliates. For example, C&P provides tariffed telephone services to its affiliate, Bell Atlantic Mobile, which provides cellular telephone service. C&P has neither sought nor obtained approval for the provision of these services from the State Corporation Commission under the statutory provisions the government cites. I am advised by counsel that such approval is not required for the provision of tariffed

services to affiliates and, to my knowledge, the State Corporation Commission has never required such approval. Nor has the fact that some of C&P's affiliates engage in non-telephone businesses, which C&P itself might be barred from engaging in, ever presented an obstacle to C&P's provision of tariffed services to them.

8. *Pole attachments.* The government alleges that "within six months of entering the cable television market, C&P could cripple the only competition" by terminating its agreements with cable operators respecting pole attachments. This prediction is not reflected in experience. C&P is in competition with cable companies today. Nonetheless, as far back as C&P's records go, C&P has not terminated an agreement for pole attachments or conduit with a cable company that was providing cable service to customers.

9. To eliminate any uncertainty about C&P's willingness to renew its agreement with Jones Intercable respecting pole attachments and conduit in Alexandria, C&P has offered to extend the agreement for the 20-25 year term of Jones's renewal of its cable franchise. (See the attached letter from James E. Howerton to Sherry Gilmore of Jones Intercable.)

10. *Franchise.* The government and others claim that the ban on video programming is justified by the fact that telephone companies have franchises to provide telephone service. C&P has certificates of convenience and necessity, issued by the State Corporation Commission, to provide local exchange and toll telephone services in many areas of the Commonwealth, including the City of Alexandria, Virginia. (The Alexandria certificate is included in plaintiffs' document appendix, vol. IV, tab 53). These certificates are not conditioned on C&P or its affiliates refraining from providing video programming.

11. Not all telephone companies have franchises, and some telephone companies have franchises that are non-exclusive. For example, C&P's affiliate, The C&P Tele-

phone Company of Maryland, has no franchise. Another of C&P's affiliates, The Chesapeake and Potomac Telephone Telephone Company, which provides telephone service in the District of Columbia, has a franchise that is non-exclusive.

12. *Alleged protection from competition.* The government and others also claim that the ban on video programming is justified by the fact that the government is supposedly protecting telephone companies from competition. In fact, the federal government has spent the last two decades promoting competition in the telephone business, preempting state law where necessary.

13. In 1970, C&P was the sole provider of telephone handsets and other customer telephone equipment in the parts of Virginia where it provides telephone service. In the late 1970s, the FCC mandated competition for equipment. The Bell Companies continue to provide telephone equipment but, according to statistics compiled by the trade association of equipment suppliers, they collectively supply only about 10% of U.S. purchases.

14. In 1970, C&P was the sole provider of pay telephones in the parts of Virginia where it provides telephone service. In 1984, the FCC opened up competition for pay telephones and preempted conflicting state laws. Today, the number of pay telephones provided by competitors is growing at the rate of 20% per year and the number of C&P's pay telephones is declining.

15. In 1970, C&P was the sole provider of local telephone services in the parts of Virginia that it serves. This was largely true even in 1984. In 1991, the FCC announced that it would promote competition in local telephone services used to originate and terminate interstate calls by requiring C&P and other telephone companies to provide new forms of interconnection with the competitive access providers ("CAPs"). Today, C&P faces competition from CAPs such as Metropolitan Fiber Systems, which provides services in Northern Virginia.

And in Richmond and in Norfolk, cable companies serving those areas are rapidly positioning themselves to provide competitive access service.

16. In 1970, there were virtually no mobile radio services in competition with local telephone services. In the early 1980s, the FCC began issuing spectrum licenses to cellular radio providers. In 1984, 32 systems had been licensed, serving some 92,000 subscribers. Today, as the parties have stipulated, licenses have been issued nationwide, there are 11,000,000 cellular subscribers, and the number of subscribers is growing 40% per year.

17. The FCC has begun licensing additional radio-based telephone service providers. The amount of spectrum to be licensed by the FCC is many times the amount allocated to current cellular providers and would be sufficient to provide telephone service to everyone in the Nation. As the parties have stipulated, the FCC has granted 203 experimental licenses for personal communication services ("PCS"), thirty five of them to cable companies. Jones Lightwave, an affiliate of Jones Intercable, holds an FCC experimental license for a PCS trial in Alexandria, Virginia. Permanent PCS licenses may be issued within a year. Under a spectrum auction bill that passed a House Subcommittee recently, the FCC would have 270 days from final passage of the bill to begin issuing PCS licenses. The same bill would preempt state entry and rate regulation of commercial mobile services including cellular service and PCS.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on 6-4-93.

/s/ H. R. Stallard
H. R. STALLARD

A Bell Atlantic Company
C&P Telephone

C&P Telephone Company of Virginia
600 East Main Street
Richmond, Virginia 23219
804-772-1591

Hugh R. Stallard
President and Chief Executive Officer

December 17, 1992

The Honorable Preston C. Shannon
The Honorable Theodore V. Morrison, Jr.
The Honorable Hullihen W. Moore
State Corporation Commission
Post Office Box 1197
Richmond, Virginia 23209

Gentlemen:

The C&P Telephone Company of Virgninia today announced plans to upgrade its telephone distribution network in Alexandria with fiber cable and associated electronics. As you know, C&P has been in the forefront of the introduction of new technology. Our announcement today expands upon that commitment and is further expression of our desire to bring the many benefits of broadband technology to our customers as quickly as economically feasible.

This acceleration of broadband technology will enable us to provide hundreds of communications channels, making possible the provision of many new services to our customers. A service that will be provided is cable TV. We will use our affiliate, Bell Atlantic Video Services Company ("BVS"), to provide this service. C&P will provide transport services on its enhanced distribution system on a common carrier and non-discriminatory basis. BVS will buy those transport services and provide pro-

grams to customers. We will provide other channels to other programmers and information providers.

Because our affiliate will provide programming, the Cable Communications Policy Act's prohibition against telephone companies providing cable TV service is applicable. We believe that the provision is unconstitutional. It violates the First Amendment right of telephone companies to provide video programming as well as the First Amendment right of subscribers to receive the video programming which C&P and its affiliated programming entity would provide. We have filed suit, therefore, in the U.S. District Court for the Eastern District of Virginia challenging the constitutionality of the Act. A copy of our complaint is enclosed.

Cable companies are increasingly entering the telephone business. They fight entry by others into their entrenched monopolies, as the enclosed article from *The Wall Street Journal* of September 24, 1992 illustrates. We anticipate these companies to react to our suit by challenging C&P in a number of forums, including before this Commission.

One claim that we expect is that C&P's entry into the cable business will lead to higher rates for its basic telephone service. Nothing could be further from the truth. C&P has not increased intrastate rate schedules for basic telephone service since the beginning of 1984.** We have no plans to increase those rates as a result of the planned investment.

The acceleration of the enhancement of our facilities in Alexandria is contingent upon our ability to provide cable TV and other information services. Those services will provide the revenues to support the broadband network. It is likely that our suit and related appeals will

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* The Act applies whether C&P provides programming directly or through an affiliate. 47 U.S.C. § 533(b).

** In fact, in the intervening nine years, C&P has actually decreased those rate schedules.

take several years, and our present plans are not to proceed with the accelerated investment until successful completion of the suit.

When we do undertake this investment, we understand that the Commission certainly would scrutinize carefully any subsequent proposal to raise basic rates. Let me repeat, we have no plans to undertake any such request.

The way to provide complete assurance that rates for basic telephone service will not increase as a result of investments to provide transport for programming and information services is to decouple the relationship which exists under current regulation between costs of telephone service (rate base/rate of return regulation) and price of service. A number of States have addressed the need for a new paradigm for the pricing of telephone service, and we hope that Virginia will do likewise in the future.

If you should have any questions about our lawsuit, I would be pleased to meet with you or your staff to discuss them.

/s/ Hugh Stallard
H. R. STALLARD

Enclosure.

A14 *THE WALL STREET JOURNAL, THURSDAY, SEPTEMBER 24, 1992*

CAPTIVE AUDIENCE: ESTABLISHED CABLE-TV FIRMS SAY THEY WELCOME COMPETITION, BUT BEHAVE OTHERWISE

CABLE FIRMS SAY THEY WELCOME COMPETITION BUT BEHAVE OTHERWISE

Some Established Systems Go To Great Lengths to Keep Rivals Out of the Game

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A Nasty Battle in Niceville

By MARK ROBICHAUX

Staff Reporter of THE WALL SREET JOURNAL

ELDOW LAKE, Minn.—This farming community has many charms: It is clean, friendly and nestled amid tiny lakes. And for a while there, residents could get paid for receiving cable television.

That is what happened when Triax Midwest Associates, an affiliate of Denver-based Triax Communications Corp., faced a challenge to its executive franchise. After years of customer complaints that Triax's service was shoddy and its rates too high, the town (pop. 1,200) decided to go into the cable business itself. It erected a 180-foot antenna across the highway from Triax's tower and hung its cables just under Triax's on the utility poles.

The municipal system quickly signed up 60% of the subscribers in town at $14.95 a month, beating Triax's

price by $1. But last summer, in the middle of a price war, Triax matched the city's rates, then flew in a legion of salespeople to go door-to-door, offering Elbow Lake citizens a rebate of $100, paid on the spot, if they agreed to sign up for a year. The city countered the next day with a monthly rate of $5.95. So did Triax. Now the town's system is struggling and faces a yearly loss. It has been forced to raise its rates back up to $14.95, and nobody knows whether the residents will stay loyal, or go for Triax's discount deals.

Slow Motion

Five years after the cable industry was deregulated, fewer than 1% of the cable markets in the U.S. are served by two or more providers, and rates have risen an average of 61% for the most popular service. Alternatives to cable, such as microwave transmission and direct-broadcast satellite reception, haven't materialized as full-fledged competitors. Complaints continue to reverberate about what many consumers perceive as cable companies' unregulated monopolies.

The bill cleared by Congress this week addresses this dissatisfaction by reimposing some community control on cable companies' behavior. The cable companies and President Bush, who says he will veto the measure, argue that the bill could actually raise costs for consumers, partly because it would enable broadcasters to obtain payments from cable companies for their signals. They maintain that competition in the cable market, not regulation, would serve consumers best.

But a close look at the few markets where entrenched cable companies have been challenged by newcomers suggests that competition is the last thing that the big cable operators want. Beyond simply playing hardball, entrenched cable operators have sought to lock out or cripple would-be competitors. They have engaged in disabling price wars, filed numerous lawsuits and hobbled

the sale of municipal competitors' bonds. They have vigorously lobbied local and state governments to keep their turf exclusive. In New York, an incumbent cable operator threatened apartment co-op boards with a halt in its service if the co-ops let a competitor in. In Cape Coral, Fla., a city famed for its Arbor Day celebrations, a cable provider charged that a would-be competitor planned to destroy 600 to 700 trees to string cable (it didn't actually plan to cut any).

'Fruits of Monoply'

"The cable industry has tasted the fruits of the monopoly and they'll do whatever they can to drive a potential competitor out of town," charges Gene Kimmelman, executive director of the Consumer Federation of America, a consumer lobby group. "They want it both ways: They argue they want competition, yet they do everything imaginable to block it."

The cable industry vigorously defends its behavior, dismissing any notion that its practices are anti-competitive. Cable companies say they are simply protecting their markets, competing as any prudent business would. The big operators feel the threat of competition acutely, because they borrowed heavily to buy up cable systems in the 1990s. Cable companies further argue that it's virtually impossible for two cable operators in one market, offering discounted prices, to make a reasonable profit. In many respects, they argue, cable is a natural monopoly.

"What do you expect the operators to do—sit there like a bump on a log and lose customers?" asks Steve Wilkerson, president of the Florida Cable Television Association. "Cable operators are going to compete head to head to keep their customers. What is so anti-competitive about that?"

Keeping Their Distance

The big cable operators haven't tried to compete with one another; they buy and sell territories, but so far they haven't sought to penetrate one another's markets. Generally the challengers are frustrated small-town governments and scrappy companies, usually undercapitalized, that operate in areas where an incumbent has a reputation for giving poor service and increasing its rates.

More than 130 disenchanted communities are exploring the prospect of either inviting competition or starting a cable company of their own. One of them is Niceville, Fla., a hamlet (formerly known as Boggy) near the end of the state panhandle. Niceville has been fighting for the better part of a decade to start its own service. Warner Cable Communications Inc., a unit of Time Warner Inc., so riled the small town with rate rises and much-criticized service that angry residents voted to tax themselves to construct a $2 million cable system.

But Time Warmer used the courts to challenge the city's right to build, arguing among other things that by operating a system of its own, the government would be infringing on Time Warner's First Amendment right to free speech. After hard-fought victories, one in state court and another in the U.S. Supreme Court, the town proceeded this year to sell the bonds to start construction. But a bond-rating agency refused to rate the bonds, despite Niceville's respectable credit history. That's because Time Warner filed yet another lawsuit in 1987. This one charged the town with "unlawful municipal competition," alleging, among other things, that it misled residents about the cable system's viability.

Today, seven years and almost $300,000 after starting its effort, Niceville still hasn't strung its first inch of wire. "They [Time Warner] asserted every constitutional, legal and contractual theory I think I've ever seen," says Niceville city attorney Gillis Powell Sr." "It's been a very complicated, very costly, very exhausting experience."

James Moore, the attorney representing Warner Communications, argues that neither Niceville nor any other municipality belongs in the cable business. "How can the city be a regulator and a competitor at the same time?" he demands.

That is one of the questions the federal reregulation bill addresses. The bill would enable local governments to regulate rates for basic cable programming based on guidelines developed by the Federal Communications Commission, and would authorize the FCC to step in when local authorities don't do the job right.

The legislation is also aimed at encouraging competition to entrenched cable operators. It would prohibit exclusive franchises, requiring cities to consider at least two applicants. Local governments could operate a cable system without going through the formal franchising process. The bill would also require cable operator-owned networks that currently sign exclusive contracts, such as TNT, to sell programming to all comers.

The Allentown Example

There is evidence that on a level playing field, cable companies can compete, with attendant benefits for consumers. In Allentown, Pa., two private cable companies started 25 years ago at opposite ends of the town, met in the middle and continued to wire over one another's neighborhoods, house by house. The two—Service Electric and Twin County Trans Video—both are profitable today, and have split the market roughly in half.

"I'm not exaggerating when I say we have no problems whatsoever with cable," says Joseph Rosenfeld, as assistant to the mayor in Allentown. "These companies are terrified of people switching. I was watching an Eagles game that went out during an electric storm. Within half an hour, in the rain, they had the thing fixed."

Allentown is an exception mainly because it took a path that other communties didn't when cable television

began: It allowed two operators into its territory. As cable spread in the early 1980's, most local governments granted a single franchise to a single operator. Running two wires along poles or digging up public roads twice seemed impractical. In turn, cable operators often had to agree to costly concessions levied by city councils, which usually included a percentage of gross revenue, elaborate public-access studios and state-of-the-art equipment to televise council meetings.

Then, in 1984, cable companies argued that they needed relief from local governments' rate restrictions and unreasonable demands. Competition from emerging technologies would hold rates down, the industry argued. Besides, the broadcast networks had a far bigger audience than cable, which had wired less than half the country at the time.

So the Cable Act of 1984, which became effective in 1987, was intended to allow the industry to flourish, and at the same time open the door for competition. The industry has indeed flourished since deregulation—revenue has almost doubled in the past six years to $22 billion—but the emerging technologies still are larval, and incumbent cable operators doing battle with newcomers can exploit the considerable advantages of having had exclusive franchises.

By far the bloodiest cable battleground, even by the industry's sanguinary standards, is in central Florida, where Telesat Cablevision Inc. has gone up against some of the nation's most powerful cable operators. The fight has taken such a heavy toll that Telesat has canceled plans for any further expansion in Florida. Telesat's parent, FPL Group, owner of Florida Power & Light, has put Telesat up for sale.

Telesat, based in Pompano Beach, touched off a price war when it marched into central Florida in 1987. It started out wiring apartment buildings, then quickly expanded to more than a dozen communities serving 52,000

cable homes, in every market. Telesat met what its president, Harry Cushing, describes as the "scorched-earth policy" of entrenched cable companies.

In the Orlando area, Telesat encountered two of the industry's biggest operators; Cablevision Industries Corp., with 1.7 million subscribers nationwide, and Cablevision of Central Florida, a division of Time Warner Inc., with 6.7 million. (The two companies are unrelated: "cablevision" is a name widely used in the industry.) In 1987, the year Telesat made its debut in Orange County, Fla., Cablevision Industries charged $10.95 a month in its markets, and the Time Warner unit $12.95. Telesat came in at $9.95.

[Chart Omitted in Printing]

Both incumbents quickly cut their rates to $6.50—but left prices unchanged in neighborhoods that couldn't get Telesat. William Brown, president of Time Warner's unit there, calls the simultaneous rate drop "coincidence," adding, "there was absolutely no collusion."

Between the price wars and the race between companies to wire homes, Orange County quickly became a hodgepodge of different cable rates for different enclaves. Cindy Utter, who lives in one of Orlando's blue-collar subdivisions, pays the Time Warner unit $20.70 a month. But just down the road, in an area that gets Telesat, her neighbors pay Time Warner $13.95 monthly. "It's not fair," Ms. Utter fumes. Counters Time Warner's Mr. Brown: "It's fair to meet competition wherever it comes up. You have to protect your market share short of losing money."

Homeowners Get Involved

In 1990, at the behest of embittered residents, the local homeowners' association took the lead in pushing for an ordinance that would prevent cable companies from

charging different prices for cable in the same market. "We had a lot of people mad that they were subsidizing their neighbor's cable bill," says Cheryl Moore, then-president of the Orange County Homeowners Association.

Time Warner orchestrated the industry's counterattack, sparing no effort to make its presence felt by local politicians. On the day the Orange County Commission voted on the proposed ordinance, big cable trucks surrounded the building, and inside, virtually every seat was taken by Time Warner employees, who had been given time off with pay to attend the meeting.

They had arrived that morning shortly after 7 a.m., for the 9 a.m. showdown. "The residents were forced to stand up in the back, and there was no parking for blocks," Mrs. Moore says. "The people were livid." Time Warner's Mr. Brown says, "We gave employees time off and it was voluntary, but I'm pleased we had such a terrific turnout."

Heated debate ensued as the sides presented conflicting economic data. In the end, the ordinance failed, 3-2, with three Republican commissioners voting against it. The incumbents' presentation was made by two cable-company attorneys active in Republican fund raising. "Special interests hit a grand-slam home run and the residents lost," Linda Chapin, a commission member who spearheaded the argument for the new ordinance, said at the time. Weeks later, during a race for the job of commission chairman, Time Warner included campaign fliers for Ms. Chapin's (ultimately defeated) opponent in its monthly cable bill.

Level Playing Field?

Telesat now blames its lower-than-projected cash flow and choked-off subscriber growth in Orange County on the failure of the ordinance. The company's 42% penetration there contrasts sharply with the 61% it achieved in nearby Citrus County, which adopted a uniform-pricing

law. (A similar uniform-pricing provision is included in the regulation bill passed by the House and Senate.)

In Dade County, Telesat got stopped dead in its tracks by a state law known as the "level playing field" act. In theory, it was designed to ensure that the second cable franchise wouldn't get more favorable treatment than the incumbent. But in the 10 states where such legislation has been enacted, many cable newcomers contend it has enabled incumbents to manipulate the franchising process. Often at the established cable company's urging, local governments hold public hearings and conduct extensive studies on the impact of so-called overbuilders. In the end, communities frequently end up imposing more burdensome financial obligations and construction schedules on second cable systems. Dade County proved no exception.

For instance, a six-month, $100,000 study into the feasibility of competition led to one delay after another in the processing of Telesat's application for a franchise. At every county meeting, Mr. Cushing, Telesat's president, says the incumbents prodded the county to ask for more data before taking any action.

Finally, after 2½ years of waiting, Telesat withdrew its application. Among other reasons, it cited in its FCC filing "no hope of overcoming incumbent opposition with close political ties to commissioners." Later that year, the Dade County cable administrator who recommended doing a feasibility study was hired by Tele-Communications Inc., owner of Storer Communications Inc., one of the incumbent operators, to run its Miami cable operations. Anthony Bello, the former cable administrator, says any suggestion that the two events were related is "poppycock," stressing that Tele-Communications had no pending business with the county at the time of his job negotiations.

Elsewhere in Florida, even as Telesat toiled to lay wire, it found it couldn't get access to popular cable pro-

gram networks, many of which are at least partly owned by the largest cable operators in the country. For instance, Telesat can't get the Sunshine Sports Network, which carries Orlando Magic basketball games and Florida State University sports. The Sunshine network is 51% owned by a group of cable operators and 49% owned by a partnership between cable entrepreneur Bill Daniels and Liberty Media Corp., a spinoff of Tele-Communications. The network is distributed through exclusive contracts to incumbent systems.

Today, Telsat is struggling in virtually all its Florida markets. Several of its operations have been sold to or merged with incumbent operators, some of which charge Telesat with being a "green-mailer"—industry jargon for a company that enters a market for the purpose of inducing a buy-out. Mr. Cushing, Telesat's president, denies the charge. "I have a firm belief in the American dream," he says, "but I am disillusioned."

The few U.S. communities that have achieved cable competition have emerged as pockets of envy for the rest of America's couch potatoes.

In Paragould, Ark., the incumbent Cablevision Systems Corp. was determined to be the only game in town. When the town launched a $3.2 million bond issue to build its own cable system, Cablevision filed two lawsuits to stop it, and even offered to finance the new system on the condition Cablevision be allowed to operate it.

But the town system is up and running, and in the face of its first competition ever, once-vilified Cablevision Systems has become a paragon of service. If it doesn't repair outages within one hour, it will give $3 off or a free month of Home Box Office. And its rates are among the lowest in the country: Cablevision charges $9.50 a month for 45 channels; the town charges $12.50.

Paragould property owners have to pay an average tax of $3 a month to defray the cost of the town's new sys-

tem, but many think it's worth it. Amanda Gramling waited for years on the edge of town for cable service from incumbent Cablevision. But it wasn't until the town got into the business that both companies—Cablevision and the town system—beat a path to her door. "We're a lot better informed today, and we have one of the lowest rates around," says Mrs. Gramling, who now tunes into the town's live coverage of the county fair and her second-grade daughter's school plays. "We can thank competition for that."

COMMONWEALTH OF VIRGINIA

[State Logo]

STATE CORPORATION COMMISSION
December 21, 1992

Mr. Hugh R. Stallard
President
C&P Telephone Company of Virginia
Post Office Box 27241
Richmond, Virgina 23261

Dear Hugh:

Thank you for your December 17 letter and enclosures, including copy of the Complaint for Declaratory Judgment and Injunctive Relief filed by C & P of Virginia and Bell Atlantic Video Services Company in U. S. District Court for the Eastern District of Virginia (Alexandria Division) on December 17, 1992.

This material was delivered to the Commissioners by Mr. Warner Brundage. We appreciate the briefing that we received concerning this suit and also your offer to keep the Commission fully informed as the matter progresses.

We understand that no part of the litigation expenses will be assessed the ratepayers of Virginia and that the Company accounts will be maintained so as to ensure Virginia ratepayer protection.

This case will be a landmark one with far-reaching implications which, in my opinion, could determine the long-range development of the communications industry in America.

With very best wishes, I remain

Sincerely,

/s/ Preston C. Shannon
PRESTON C. SHANNON

PCS/ch

cc: Hon. Theodore V. Morrison, Jr.
Hon. Hullihen Williams Moore
Mr. Edward C. Addison

A Bell Atlantic Company
C&P Telephone
Legal Department

C&P Telephone Company of Virginia
600 East Main Street
10th Floor—Plaza
P.O. Box 27241
Richmond, Virginia 23261
804-772-1559

May 7, 1993

Jones Intercable Inc.
9697 E. Mineral Avenue
Englewood, Co. 80112

Attention: Sherry Gilmore
Legal Assistant

Dear Ms. Gilmore.

I understand that Jones is currently seeking a 20-25 year renewal of its franchise in the City of Alexandria, Virginia. As you know, the current Pole Attachment and Conduit Occupancy Agreement between C&P and Jones runs from year to year and is renewed each year automatically. This contract has been in place since 1979 and, frankly, I do not see or anticipate any reason for changing this arrangement. However, if you would be interested in a longer term contract to run concurrently with the time period of your renewed franchise, C&P would be willing to enter into such a contract.

If you are interested in negotiating a longer term contract, or have any questions, please call me.

Very truly yours,

/s/ James E. Howerton
JAMES E. HOWERTON
Claims Manager

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

[Caption Omitted in Printing]

AFFIDAVIT OF ROBIN SMITH

Robin Smith deposes and says:

1. I am the founder and current President and Chairman of the Board of Video/Action Fund, a public charity and independent production company that develops, documents, and promotes educational video programs. Prior to founding Video/Action Fund, I worked for more than fifteen years as a producer and filmmaker. From 1980 to 1986 I was a producer for two broadcast television networks: NBC, where I worked with the programs "1986" and "American Almanac," and CBS, where I worked with the programs "Sunday Morning With Charles Kuralt" and "The CBS Morning News." I have received a Master of Science in Public Communication from Boston University and a Bachelor of Fine Arts degree from Ohio University. My resume is attached as Appendix A.

2. Since its creation in 1990, Video/Action Fund has produced such programs as: "Who's Gonna Sing Our Song?"—a documentary on a multi-media project in which inner-city teenagers explored the history of their neighborhood through the arts; "Women of Substance"—an advocacy video on the barriers facing pregnant and parenting addicts when they seek treatment; and "Shooting Back: Photography By Homeless Children," which won a regional Emmy for outstanding documentary in 1991.

3. Video/Action Fund is one of a growing number of non-commercial production and media arts organizations through which artists, educators and independent producers are creating an enormous volume of culturally diverse programming. Appendix B to this affidavit provides a partial list of such organizations working on educational and public interest programming at the community level.

4. The primary outlets for programming created by independent producers working on shoe-string budgets outside of the commercial mainstream media are non-broadcast venues such as film festivals, school, library and museum programs, and community access cable. The number of people that are able to see this programming is limited by the size of auditoriums and screening rooms, as well as the ability of producers to make the community aware of the exact time the programs are being shown. We know there is a demand for what we produce because the audiences—limited as they currently are—are packed with under-represented people of all cultural, political and social identities eager to see or hear themselves on the screen.

5. Video/Action Fund—like all independent producers and media artists—seeks the broadest possible access to audiences and will utilize all distribution services available to us. Our productions have been shown on both broadcast and cable television. We also rely on mail order delivery of video cassettes. However, there are barriers in the current marketplace that inhibit the ability of non-commercial producers to disseminate all of our programming. Network show producers and cable broadcasters have a limited number of channels and are often looking for programming that fits a certain type or subject niche. Programming that doesn't "fit in" to existing schedules and formats is not considered for broadcast or distribution.

6. Independent producers and media artists are producing much more video programming than is currently being distributed on existing systems. As long as show producers and distributors stand as "gatekeepers" for the viewing audience, voices that do not conform to the video carriers' needs will not be heard.

7. For these reasons, independent producers like Video/Action Fund need and would welcome the development of new distribution channels and new program packagers for video and multimedia programming. Bell Atlantic Video Services' ability to package, market, and distribute video programming for access on demand presents new opportunities for independent producers and media artists to reach a much larger audience.

8. As telephone companies and others deploy new distribution alternatives, the existing "gatekeepers" will lose their power to limit the public's access to educational and community-oriented programming. Independent producers like Video/Action Fund will gain greater access to their audiences. A new genre of programming will emerge, utilizing the new interactive technologies in ways that are more responsive to the needs of individuals. Business relations and the interface between producers and distributors will improve. With more distribution outlets, small independent and non-profit producers will gain a precious commodity—a platform for diverse voices and visions that can be shared with the broadest possible audience.

9. Some parties defending this case have suggested that Bell Atlantic already has numerous opportunities to provide a forum for the voices of independent producers like the Video/Action Fund. They note that the video programming ban applies only to in-region programming carried over the telephone company's facilities and they cite the exemption for rural areas even within the company's service-area. They also claim that Bell Atlantic

can produce its own programming and either buy an existing over-the-air broadcaster or lease facilities from existing cable operators to show that programming.

10. Whether these statements are valid legally lies beyond the scope of my statement. However, the alternatives they suggest, even if true, simply would not solve the problems I have discussed above. The fact that Bell Atlantic may provide cable service in rural areas would not be helpful to many independent production entities which are located mostly in metropolitan areas and seek to give a voice to the concerns of people in those areas. Similarly, Bell Atlantic's ability to supply video programming of its own (such as NCTA's suggested "Bell Atlantic Hour"), will not help entities like the Video/Action Fund which need new outlets for their own shows. Production of additional programming, without also increasing the available channels of communication, would exacerbate, not ease, the problems which small producers face. And if BVS were to lease cable facilities, the number of distribution outlets left for community-based producers to lease would actually decrease.

11. The fact that Bell Atlantic might be able to purchase a cable system outside its region also would not increase the number of distribution outlets. The key value of Bell Atlantic's proposal to existing producers is that Bell Atlantic plans to use existing telephone facilities to provide new distribution outlets in competition with the existing cable provider. This will increase the number of channels available and hence increase the demand for programming from independent producers like Video/Action Fund. In other words, it is precisely because Bell Atlantic plans to provide video programming within its service area that its proposal is likely to increase the diversity of voices.

12. Nor would the FCC's recent action allowing telephone companies to provide a "video dialtone" service be of practical assistance to independent producers like

Video/Action Fund. Video dialtone in fact offers little if any improvement over the existing public access channels mandated by most cable operators' franchises. From the perspective of my organization and others similarly situated, mere provision of transmission facilities is not sufficient. Bell Atlantic would still be forbidden to perform the kinds of packaging, marketing and publicity functions that are crucial to the success of smaller producers. As I have already explained, having such services available to all providers can make the difference between a film that passes unnoticed and a professional production that serves to challenge people by adding to the diversity of opinion in the public forum.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on the 4th day of June, 1993.

/s/ Robin Smith
ROBIN SMITH
President
Video/Action Fund
3034 Q Street, N.W.
Washington, D.C. 20007

Appendix A: Resume of Robin Smith

* * * *

PRODUCTION CREDITS:

1993 "ART FOR EYES" (VIDEO/ACTION FUND) Executive Producer of a 30-minute documentary on the work of EYE CARE, an organization which collects and sells Haitian art in the United States to fund eye care clinics in Haiti.

1993 "WE ARE NOT WHO YOU THINK WE ARE" (VIDEO/ACTION FUND) Executive Producer of a 10-minute advocacy video in collaboration with THE WOMEN IN JAIL AND PRISON PROJECT OF THE CORRECTIONAL ASSOCIATION OF NEW YORK, examining the involvement of women in illegal drug activity from the point of view of women serving lengthy prison sentences for drug-related crimes.

1992 "WHO'S GONNA SING OUR SONG?" (VIDEO/ACTION FUND) Executive Producer of a 30-minute documentary profiling a multimedia history and humanities project developed by VIDEO/ACTION for sixty teenagers living in southeast Washington, D.C.

1992 "WOMEN OF SUBSTANCE" (VIDEO/ACTION FUND) Co-Producer of a 10-minute advocacy video exploring the problems encountered by addicted pregnant and parenting women seeking treatment for alcohol and drug abuse.

1992 "FOR REAL" (VIDEO/ACTION FUND) Executive Producer of five point-of-view videos addressing attitudes, lifestyles and perceived health care options of "at-risk" teenagers for use in a community Services Workstation—

a demonstration project funded by the Office of Disease Prevention and Health Promotion, Department of Health and Human Services.

1992 "ONE BLOCK AT A TIME" (VIDEO/ACTION FUND) Executive Producer of a 30-minute public service documentary on community-based efforts to combat substance abuse-related problems in the Washington metropolitan area; sponsored by Blue Cross/Blue Shield of the National Capitol Area and WRC-TV as part of a five year Drug-Free Zones Campaign.

1991 "YOUNG WOMEN'S RESIDENCE" (VIDEO/ACTION FUND) Executive Producer of a 10-minute video on a home for sexually and emotionally abused teenagers in St. Petersburg, Florida.

1991 "LOADED" (VIDEO/ACTION FUND) Executive Producer of a 30-second public service announcement on the dangers of drinking and driving.

1990 "SHOOTING BACK: PHOTOGRAPHY BY HOMELESS CHILDREN" (VIDEO/ACTION FUND) Executive Producer, Writer and Director of an award-winning 30-minute documentary on Jim Hubbard's work with homeless children which resulted in an exhibition of photographs showing life in the shelters through the eyes of children. (Broadcast nationally on PBS and The Learning Channel; recipient of Capitol Regional Emmy, National Academy of Television Arts and Sciences, and "Silver Apple," National Educational Film and Video Festival; selected to be screened at the International Monetary Fund

and the Council on Foundations Film Festival)

1990 "BEST BUDDIES!" (VIDEO/ACTION FUND) Executive Producer of a 10-minute profile of Anthony K. Shriver's national non-profit, volunteer program which introduces college students to people with mental retardation in an effort to promote friendship and an appreciation for community service.

1986-1991 NBC NEWS "SUNDAY TODAY" Field Producer of feature segments, including profiles of controversial photographer ROBERT MAPPLETHORPE, television personality MORTON DOWNEY, JR., and disabled Vietnam veteran, LEN NICHOLLS, who established a clinic for amputees in Hanoi.

1989 "TONY COELHO ON EPILEPSY" Producer and Director of a 10-minute video for THE COELHO FUND in which the former Congressman talks about his struggle with epilepsy.

1989 "SEEKING ANSWERS" Producer of a 20-minute informational video for THE NATIONAL LEAGUE OF FAMILIES OF AMERICAN PRISONERS AND MISSING IN SOUTHEAST ASIA.

1988 "THE BEST AMERICA" Producer and Director of a 30-minute special for the MICHAEL DUKAKIS PRESIDENTAL CAMPAIGN which was broadcast election eve simultaneously on all three networks.

1988 "HOMELESS IN AMERICA" Producer and Director of an award-winning video for TRIANGLE INDUSTRIES and THE MENTAL HEALTH ASSOCIATION which documents the

plight of homeless individuals and families across the country.

1987-1989 "USA Today on TV" Producer of cover stories including "SHOULD DRUGS BE LEGALIZED?," "FETAL ALCOHOL SYNDROME CHILDREN," "SHOULD MOTHERS OF CRACK BABIES BE PROSECUTED FOR CHILD ABUSE?" and "DISCRIMINATION AGAINST GAYS IN THE MILITARY."

1985-1986 NBC NEWS "1986" and "AMERICAN ALMANAC" Producer of numerous feature segments, including "A TICKET OUT," about a musical written and performed by inner city kids living in Chicago's Cabrini Green housing projects, and "LEAN ON ME," an award-winning feature on a special program in which victims of crimes and tragedies help others in similar straits.

1980-1985 CBS NEWS "SUNDAY MORNING" Producer of numerous features, including profiles of JOHN THOMPSON, Georgetown's controversial basketball coach; KATHERINE DUNHAM, founder of the first black dance company in America; and PHILLIPPE PETIT, high wire artist and street performer.

1979 "HE'S ONLY MISSING" Producer and Director of an award-winning half-hour documentary film on my father, a USMC aviator missing in action in North Vietnam.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA

[Caption Omitted in Printing]

AFFIDAVIT

DISTRICT OF COLUMBIA, S.S.

Bruce M. Owen, being duly sworn, deposes and says:

1. I am the president of Economists Incorporated, a Washington, DC economic consulting firm, and visiting professor of economics at Stanford University's Washington campus. I previously submitted an affidavit in this proceeding which summarizes my qualifications.

2. I have reviewed Plaintiffs' June 5, 1993 filings in this matter including the affidavit of their expert, Professor Kahn. Plaintiffs and their expert have mischaracterized my position as to why telephone company provision of video programming services in their telephone service areas raises serious competitive issues. I believe, for the reasons given in my earlier affidavit, that permitting telephone companies to provide video services in competition with other local sources of video programming will likely result in anticompetitive behavior in two related activities. Absent the ban on participating in video programming services, telephone companies will use their regulated telephone revenues to cross-subsidize and monopolize video transmission services. Telephone companies will then use their control of essential transmission facilities to deny access to and discriminate in favor of their pro-

gramming services affiliates, thereby allowing them to exclude competitors and earn above competitive profits for video services, as discussed in my earlier affidavit at ¶ 7.

3. Plaintiffs and their expert entirely miss the point regarding the relevant cross-subsidy issues raised in this matter and the crucial role played by § 533(b) in preventing anticompetitive abuses. Plaintiffs claim "§ 533(b) has nothing to do with preventing cross-subsidies, for the simple reason that telephone companies are *already permitted* to carry both telephone calls and video signals over their phone wires." Plaintiffs' Reply Memorandum at 33, emphasis in original. Similarly, Professor Kahn claims there is "no rational connection between the defendants' cross-subsidy argument and the ban against telephone companies providing video *programming*" because there could not be substantial costs common to the transmission of video programming and to the creation and packaging of video programming. Kahn Affidavit at ¶ 7, emphasis in original. Both arguments miss the mark because they ignore the central function of § 533(b) in curbing telephone companies' incentives to engage in cross-subsidization.

4. There are undeniably substantial common or joint costs involved in the provision of video transmission services and the provision of monopoly telephone services. Telephone companies are in a position to cross-subsidize video transmission service from monopoly revenues. What Plaintiffs and Professor Kahn ignore is that telephone companies' incentive to engage in that cross-subsidization is greatly enhanced if telephone companies are also allowed to exploit monopoly control of video transmission by earning excess profits in video programming. Simply put, the removal of § 533(b) would make a video transmission monopoly more valuable to a telephone company.

This makes it more likely that a telephone company will engage in anti-competitive cross-subsidization in order to obtain the video transmission monopoly. Because § 533(b) denies telephone companies the incentive and ability to discriminate against video programming competitors in order to earn excess profits in that activity, § 533(b) reduces the incentive to cross-subsidize video transmission in the first place. If a non-vertically-integrated telephone company discriminates against users of its video transmission service, raising their costs of doing business, it simply loses revenues from those customers. But if those customers' lost sales increase the market share and unregulated profits of the telephone company's programming affiliate, there is a net gain for the telephone company—it benefits from trading regulated, low-profit sales for unregulated, high-profit sales. The effect of being in the unregulated video programming business therefore is to increase the profitability to the telephone company of obtaining a monopoly of video transmission. Thus, § 533(b) protects competition in *both* video transmission and video programming and reduces the incentive for anti-competitive cross-subsidization, as I explained in my earlier affidavit at ¶¶ 15, 23 and 27.

5. Notwithstanding its irrelevance to him, Professor Kahn doubts whether telephone companies could cross-subsidize video transmission services from monopoly telephone services. Kahn Affidavit at ¶¶ 8-15. I disagree. Telephone companies retain monopoly power over many of their services; there certainly is no substitute for residential telephone service today, for example. Professor Kahn asserts that newer "incentive" regulatory arrangements have weakened the incentive or ability of telephone companies to cross-subsidize competitive services from monopoly services. As I pointed out at length in my original affidavit in this

proceeding (see ¶¶ 35-36), incentive or price-cap regulatory schemes cannot eliminate cross-subsidization because they do not sever the relationship between prices and costs for regulated services. In practice, telephone companies are likely to anticipate that cost-based rate reviews will occur at periodic internals; in the FCC jurisdiction it is every three years. Professor Kahn simply has ignored these arguments. As long as the relationship between costs and prices remains, shifting costs from competitive activities to monopoly activities will be profitable for telephone companies. Further, I am puzzled by Professor Kahn's assertion that, because telephone companies themselves allegedly have been the principal proponents of these newer incentive plans, the new plans therefore must offer protection against cross-subsidization. Kahn Affidavit at ¶ 13. This is a *non-sequitur*. It would be considerably less naive to draw exactly the opposite inference from telephone company support for these new regulatory schemes.

6. Professor Kahn also mistakes the potential cross-subsidization involved from misallocating the increased costs attributable to risk taking. Kahn Affidavit at ¶ 15. I did not claim, as Professor Kahn appears to believe, that companies with lower overall costs of capital should be excluded from competing against companies with higher overall costs of capital. The misallocation I was discussing involved passing the costs of engaging in risky competitive activities onto less risky monopoly services. Telephone companies providing only franchise monopoly services have low risks and appropriately enjoy low capital costs. Expanding their activities into competitive areas increases their risk and therefore their overall cost of capital. In a perfect world, regulators would not permit increases in the prices charged for monopoly services

because of the added risks and higher capital costs telephone companies take on when they expand into competitive activities. In practice, because a single firm provides both, the separate costs of capital for the two types of service are hidden from regulators, who can see only the capital costs of the firm as a whole. Thus, regulators see only the higher overall required rate of return that reflects the risky competitive activity. By allowing telephone companies to earn a higher rate of return in monopoly services reflecting their overall cost of capital, regulators in fact are permitting telephone companies to engage in cross-subsidization.

7. Professor Kahn also mischaracterizes the competitive concern involved in "self-dealing". Kahn Affidavit at ¶ 16. He claims there is a important distinction in that it is not the telephone company that here proposes to purchase programming from an affiliate, but rather the programming affiliate that would buy video transport service from the telephone company. But this distinction has no weight. Whichever way the telephone company decides to go, telephone company provision of video services presents a serious competitive problem. Under Professor Kahn's scenario, the programming affiliate will still be able to charge above-competitive prices because of the handicaps faced by its competitors who require access to the affiliated monopoly transmission service. Given that the telephone company will own the underlying video transmission monopoly and will be in a position to discriminate against its video affiliate's competitors, the video affiliate will have market power attributable to its competitors' artificially higher costs, which it will have every incentive to exercise. That is exactly analogous to the local Bell companies' former discrimination in favor of AT&T's former Long Lines Depart-

ment, that provided long distance telephone service in competition with alternative long distance carriers such as MCI. In the long distance market, competitors such as AT&T or MCI today purchase transmission services from local telephone companies, just as Professor Kahn would have the programming affiliate of C&P purchase local video transmission services from itself. Regulators were unable to remedy discrimination against long distance competitors of AT&T when AT&T owned the local companies. This practice led to the breakup of AT&T and the continuing restrictions on local Bell company provision of inter-LATA long distance service. That the long distance companies purchase local transmission service to reach their customers rather than the local companies purchasing long distance services makes a difference only in the details of the anticompetitive tactics, not in their likelihood or magnitude. To ban local telephone company provision of interexchange service was the only effective remedy. The same ban is needed against telephone company provision of video programming in order to prevent the same types of competitive abuses.

8. Professor Kahn concludes that there is no economic basis for the expectation that permitting the telephone companies to provide video programming directly to the public within their service areas would put them in a position to deny other video providers a fair opportunity to compete or, through cross-subsidization, to drive them from the market. For the reasons put forward in this and my earlier affidavit, I disagree.

/s/ Bruce M. Owen
BRUCE M. OWEN

[Notarization Omitted in Printing]

EXCERPTS FROM PRINCIPAL GOVERNMENT DOCUMENTS

As shown by the following excerpts, the government agencies responsible for telecommunications policy have concluded that the video programming ban in section 533(b) is unnecessary, anticompetitive, and should be lifted. The full text of the documents from which these passages have been extracted are included in the Plaintiffs' Document Appendix ("Pl. Doc. App.").

A. *Federal Communications Commission*

1. *Telephone Company-Cable Television Cross-Ownership Rules*, 7 FCC Rcd 5781 (1992) (Pl. Doc. App., Tab 1).

> —Based on a full administrative record, the FCC has recommended that Congress "permit the local telephone companies to provide video programming directly to subscribers in their telephone service areas, subject to appropriate safeguards. We find that such an amendment would . . . increas[e] competition in the video marketplace, spur[] the investment necessary to deploy an advanced infrastructure, and increas[e] the diversity of services made available to the public." *Id.* at 5847.
>
> —According to the FCC, "[t]he original justification for the cross-ownership ban in 1970 was to prevent local telephone companies from preemptively establishing a monopoly position in the provision of cable television service and other video services. The Commission was concerned that without the cross-ownership prohibition, local telephone companies would be the first to build cable systems in their communities and would be able to . . . establish themselves as sole providers of cable service and foreclose competition." *Id.* at 5848.

—"We conclude that the risks of anticompetitive conduct by the local telephone companies in connection with the direct provision of video programming have been attenuated by the enormous growth of the cable industry. . . . Rather than a fledgling industry unable to compete, the cable industry holds a leading position in the delivery and provision of video programming to the American public. . . . Given this widely changed competitive situation . . . there is little threat that the local telephone companies could preemptively eliminate competition and monopolize the market for video services." *Id.* at 5848-49.

—The FCC elaborated: "[W]e agree with those parties that argue that permitting local telephone companies to directly provide video programming will further increase diversity, as they will add another programming voice to those which now exist. . . . [W]e agree with DOJ that vertical integration should increase rather than reduce available programming. . . . Most importantly, we find that the public will benefit greatly from the resulting increased competition in the video marketplace . . . . [W]e conclude that the ability of local telephone companies to have significant ownership interests in video programmers, particularly independent and start up services, will further increase competition in the video market." *Id.* at 5849-50.

2. Letter from FCC Chairman James H. Quello to Hon. Edward J. Markey (Mar. 1, 1993) (Pl. Doc. App., Tab 3).

——According to Chairman Quello, "the majority in the Commission's video dialtone order found that telephone companies should be permitted to provide video programming directly to subscribers as a means of increasing competition in the video marketplace. The Commission has stated that the introduc-

tion of competition from local telephone companies in the video marketplace, subject to the safeguards . . . can be expected to bring consumers lower rates, more responsive customer service, and greater choice of video programming sources." *Id.* at Att. p. 3.

3. *In re Teleport Communications-New York*, 7 FCC Rcd 5986 (1992) (Pl. Doc. App., Tab 17).

—According to the FCC's order in this proceeding, "arguments that the telephone-company-cable cross-ownership restriction is no longer necessary are well taken. This Commission favors repeal of the statutory cross-ownership restriction, and we are recommending to Congress that the prohibition be repealed, and that traditional local exchange carriers be permitted to provide video programming in their telephone service areas pursuant to safeguards." *Id.* at 5988.

4. Report of the Federal Communications Commission Regarding the President's Regulatory Reform Program (Apr. 28, 1991) (Pl. Doc. App., Tab 2).

—According to the report: "Chairman Sikes has testified that the current statutory ban on telephone companies' providing competitive video services in their local service areas should be repealed, and instead the Commission should be authorized to permit local telephone company ownership and operation of cable television facilities." *Id.* at 30.

—The report also quantifies some of the expected benefits of competition: "Paving the way for telephone companies to provide the means for active rivalry in local multi-channel video markets would result in significant price savings for consumers and stimulate provision of a range of new information services. Current experience with head-to-head competition in cable markets indicates that rates would fall about 20% for the entire video package; if com-

petition is introduced nationwide, subscribership would likely expand by 11.2 million households. This implies annual consumer surplus gains (in Year 5 after the initiation of competition) of $5.36 billion, with net social benefits of approximately $750 million. This does not count the significant gains in innovative uses of broadband communications in non-entertainment markets such as health care, education, and telecommuting, all of which are very likely to follow from enhanced capacity and competitiveness in the supply of cable television services, nor does it include possible technological or macroeconomic stimulus from the $28 billion investment which is anticipated from competitive entry into video." *Id.* at 16.

5. *Telephone Company-Cable Television Cross-Ownership Rules*, 3 FCC Rcd 5849 (1988) (Pl. Doc. App., Tab 9).

—"The growth and financial success of the cable industry lessens the need for a prohibition on telephone company provision of cable television service and we do not believe a ban is now the correct option for achieving and preserving a competitive broadband marketplace. . . . Moreover, the ban also has an undesirable effect, in that it excludes a potential competitor to a mature cable industry. This is especially of concern if less draconian means are available by which to ensure against anticompetitive conduct by telephone companies." *Id.* at 5853.

—"We believe that the growth of the cable industry to the point where telephone companies can no longer preemptively eliminate cable competition and the fact that nonstructural safeguards are available, have rendered the cross-ownership ban presumptively unnecessary." *Id.* at 5854.

—"The ban is . . . a restriction on output which deprives society of services that otherwise could be provided by telephone companies. . . . [C]ompetition provided by telephone companies can be expected to provide the benefits we have generally associated with the provision of competition in the supply of communications facilities and services. These benefits include lower costs and greater choices for consumers and greater responsiveness to consumer demand by service providers." *Id.* at 5857.

—"[B]ecause allowing carriers to provide [video programming] subject to safeguards is more likely to achieve the Commission's objective of a fully competitive marketplace for broadband communications . . . we tentatively conclude that the costs of the cross-ownership ban exceed the benefits and that the public interest would be better served by . . . allowing telephone companies to provide cable television service subject to appropriate safeguards." *Id.* at 5858.

—"The evidence before us suggests that the prohibition against telephone companies providing cable television service within their telephone service areas no longer serves the public interest. . . . The ban directly deprives consumers of video programming services telephone companies could provide, prevents operation of market incentives and achievement of efficiencies that could bring additional services to the public, and nonstructural alternatives to the prohibition, including accounting safeguards, appear likely to control telephone companies' potential anticompetitive conduct without depriving consumers of telephone company services." *Id.* at 5866.

B. *Department of Justice*

1. Reply Comments of the United States Department of Justice, *Telephone Company-Cable Television Cross-*

Ownership Rules, CC Dkt 87-266 (Mar. 13, 1992) (Pl. Doc. App., Tab 6).

—The Department of Justice has concluded that telephone companies "should be allowed to own and directly provide video progamming," and that telephone company "provision of video programming will have procompetitive benefits that outweigh any anticompetitive risks involved." *Id.* at 44-45.

—According to the Department of Justice, removing the video programming ban "will allow another competitor to enter the video programming market . . . increase the [telephone companies'] willingness to take the financial risk of developing broadband integrated networks . . . make them more effective competitors, and will create an alternative player with whom third parties can bargain to carry their programming." *Id.*

2. Letter from Attorney General William P. Barr and Secretary of Commerce Barbara Hackman Franklin to Hon. Edward J. Markey (Apr. 1, 1992). (Pl. Doc. App., Tab 19).

——"It has been the Administration's consistent position that competition . . . creates the most substantial benefits for consumers and the greatest opportunities for American industry. Television viewers will be best served by removing barriers to entry by new firms into the video services marketplace. The Administration, therefore, supports removal of current legislative prohibitions against telephone company provision of video programming, with appropriate safeguards." *Id.* at 1.

3. Letter from Assistant Attorney General, Antitrust Division, James F. Rill and Secretary of Commerce Robert A. Mosbacher to Hon. John C. Danforth (Mar. 13, 1991) (Pl. Doc. App., Tab 20).

—"It has been the Administration's consistent position that competition . . . creates the most substantial benefits for consumers and the greatest opportunities for American industry. We think that Congress can best serve television viewers by removing barriers to entry by new firms into the video services marketplace. The Administration therefore supports removal of current legislative prohibitions against telephone company provision of video programming." *Id.* at 1.

C. *Department of Commerce*

1. Commerce Secretaries Robert Mosbacher and Barbara Franklin have each signed letters that "support[] removal of current legislative prohibitions against telephone company provision of video programming." *See supra* I.A.2-3.

2. National Telecommunications and Information Administration, *The NTIA Infrastructure Report, Telecommunications in the Age of Information* (Oct. 1991) (Pl. Doc. App., Tab 4).

—Based on this in-depth study, the NTIA, the branch of the Department of Commerce that is expert on telecommunications issues, concluded: "[T]he likely benefits of LEC [local exchange carrier] entry into the video programming business outweigh the potential costs of LEC provision of video programming, which are either overstated or can be effectively ameliorated by adapting existing regulatory safeguards to suit the video programming marketplace. Such entry would be one important means for expanding competition in the provision of video programming to the home. LEC provision of video programming would offer direct competition to incumbent cable systems. Moreover, requiring LECs to make channel capacity available on a common carrier basis would multiply opportunities for entry

by independent program providers, thereby stimulating competition still further." *Id.* at 235.

—"Repealing the cable-telephone company cross-ownership restriction could also promote development of the U.S. telecommunications infrastructure. The opportunity to provide programming should increase LECs' incentives to construct integrated broadband network facilities to carry that programming to the home. This, in turn, could lead to introduction of a wide range of innovative voice, data, and video services for subscribers." *Id.*

—"Allowing LECs to own, control, and provide video programming over their own facilities, subject to effective safeguards, could promote infrastructure development by increasing their incentives to deploy integrated broadband systems and other advanced networks. In general, government restrictions that have the effect of limiting the uses to which new technology can be put tend to be *inefficient and anti-competitive,* and retard investment in that new technology. In particular, we believe that the current cable/telco crossownership rules are having such an effect with respect to investment in broadband public network technology." *Id.* (emphasis added).

—"[A]llowing LECs to participate in the video services market . . . could provide some assurance that LEC broadband distribution facilities will be used, in an active and timely fashion, for the distribution of video entertainment programming. In such an investment environment, the LECs will clearly have greater incentives to deploy such [broadband] facilities. Moreover, once those facilities become established, they could well attract additional, unaffiliated program packagers, thus giving LECs further incentives to expand and upgrade their broadband networks. Finally, the availability of broadband facilities will likely spawn new applications—video and non-video alike—as entrepreneurs and

carriers devise new service offerings that will benefit the American public." *Id.* at 243.

—"LEC common carriage of unaffiliated programming, combined with LEC ability to provide programming, will promote, not hinder, diversity. . . . The nondiscriminatory common carrier model for LEC participation in the home video market will promote diversity by permitting both the LEC and unaffiliated video providers to deliver programming over LEC transmission facilities." *Id.* at 234.

3. Comments of NTIA, *Telephone Company-Cable Television Cross-Ownership Rules,* CC Dkt 87-266 (Feb. 3, 1992) (Pl. Doc. App., Tab 5).

—According to NTIA, "the full benefit of LEC participation in the video services market will be achieved only if the concept of "video dialtone" is extended to allow LECs to provide video programming in their local service areas. Accordingly, we urge the Commission to . . . recommend that Congress repeal the crossownership restriction in its entirety, subject to competitive safeguards, including the requirement that LECs make distribution facilities available to unaffiliated video programmers on a common carrier basis." *Id.* at 3.

—The NTIA elaborated that "although LEC provision of video distribution facilities on a common carrier basis should help promote competition, diversity, and infrastructure development, LECs may have only limited incentives to deploy such facilities unless they also have the ability to invest in, and offer their customers, video programming. . . . Government regulations should not preclude such investments (and the benefits that they produce) unless there are clear anticompetitive effects that cannot be addressed by less restrictive measures, such as regulatory safeguards. NTIA therefore urges the Com-

mission to move promptly to recommend that Congress repeal the telephone-company cable crossownership restriction in its entirety." *Id.* at 7-8.

4. Reply of the National Telecommunications and Information Administration, *In re Teleport Communications—New York*, File No. 13135-CF-TC(3)-92 (May 27, 1992) (Pl. Doc. App., Tab 8).

—"NTIA shares . . . concerns about the continuing wisdom of [the video programming] restriction, and we have repeatedly advocated its elimination. Allowing telephone companies to provide video programming in their local service areas would significantly increase competition in the video services market, which would, in turn, yield lower prices to viewers, better service quality, and better programming diversity. Further, allowing telephone companies to participate fully in the video services market should also stimulate development of the nation's telecommunications infrastructure, with concomitant benefits for all users, residential and business alike." *Id.* at 3.

5. Statement of Acting Assistant Secretary of Commerce for Communications and Information Thomas J. Sugrue Before the Senate Subcommittee on Communications on S.1200 (Feb. 28, 1992) (Pl. Doc. App., Tab 15).

—"[R]emoving a statutory barrier to broader telephone company provision of video programming, when coupled with safeguards to prevent anticompetitive behavior, . . . would increase competition in the video services marketplace. That should lead, in turn, to lower prices, better service, and a wider range of programming for consumers." *Id.* at 1.

—"I would like to reiterate the Administration's strong support for . . . the proposal to eliminate the existing telephone-cable cross-ownership restric-

tion. . . . [G]iving local exchange carriers ('LECs') freedom to participate in the video services marketplace should both expand competition in the provision of such services to the home and create incentives for LECs to construct advanced broadband facilities for the delivery of video to the home, which could promote development of our nation's telecommunications infrastructure. . . ." *Id.* at 5.

—"Despite the fact that technology increasingly would permit each of these two systems [telephone and cable] to offer a full range of services in direct competition with the other, despite the fact that this country has a strong commitment to competition over monopoly as the best economic structure to serve our people, we today prohibit, or severely restrict, competition between these two systems as a matter of public policy. The rationale for government imposed walls between these potential competitors is less convincing today than it once might have been. It is one thing to regulate when competition is not feasible; it is another to affirmatively regulate against competition when there are strong indications that competitive forces are straining against such regulations for a chance to emerge." *Id.* at 8-9.

EXCERPTS FROM PRINCIPAL GOVERNMENT DOCUMENTS[1]

A. *Federal Communications Commission*

1. *Telephone Company-Cable Television Cross-Ownership Rules*, 7 FCC Rcd 5781 (1992) (Pl. Doc. App., Tab 1).

> —The FCC's Order authorizing telephone companies to provide video dialtone states: "We conclude that existing safeguards against discrimination and cross-subsidization in the provision of basic services by the local telephone companies . . . should effectively protect against potential anticompetitive conduct by local telephone companies providing video dialtone." *Id.* at 5827.
>
> —"We further conclude that our existing safeguards with respect to nonregulated services are sufficient at this time to protect cross-subsidization. . . . [T]he Commission presently has in place a comprehensive system of cost allocation rules and cost accounting safeguards designed to separate non-regulated service costs from regulated service costs. In addition, we have recently strengthened these cost accounting safeguards in order to ensure that the Commission is able to prevent and detect abuses should they occur. To the extent that a local telephone company provides nonregulated services as part of video dialtone, these safeguards will apply fully. . . ." *Id.* at 5828-29 (citations omitted).
>
> —"As for the provision of enhanced services by local telephone companies, we note that in addition to the above accounting safeguards designed to prevent cross-subsidization between regulated and non-

[1] The full text of the documents from which these passages have been extracted are included in the Plaintiffs' Document Appendix ("Pl. Doc. App.").

regulated, the [telephone companies] are also subject to a comprehensive regulatory framework designed to protect against discrimination and other anti-competitive conduct. Among these safeguards is our ONA [Open Network Architecture] policy, which we have concluded constitutes an effective safeguard to ensure that independent [enhanced service providers] are able to obtain non-discriminatory access to basic [telephone company] services. We are not persuaded that there is any functional difference between the provision of enhanced services in the context of video dialtone and the provision of enhanced services generally." *Id.* at 5829-30 (citations omitted).

—In recommending repeal of the video programming ban, the FCC states: "We conclude that the risks of anticompetitive conduct by the local telephone companies in connection with the direct provision of video programming have been attenuated by the enormous growth of the cable industry. . . . Given this widely changed competitive situation, we find it reasonable to conclude that, with appropriate safeguards on their entry, there is little threat that the local telephone companies could preemptively eliminate competition and monopolize the market for video programming services." *Id.* at 5848-49.

2. *The Chesapeake and Potomac Telephone Company of Virginia*, W-P-C-6834, Order and Authorization (rel. Mar. 25, 1993) (Pl. Doc. App., Tab 61).

—The FCC's Order authorizing C&P to provide video dialtone service states: "[W]e believe that our existing safeguards, in conjunction with the requirement that C&P offer non-discriminatory access to the basic platform, are adequate to protect against anti-competitive conduct by C&P. Among these safeguards are the cost allocation rules and cost ac-

counting safeguards designed to separate nonregulated service costs from regulated service costs . . . our ONA policy, which we believe constitutes an effective safeguard to ensure that independent enhanced service providers are able to obtain nondiscriminatory access to basic services, and our nondiscrimination reporting requirements, and network disclosure rules. . . . We are not persuaded, nor has it been shown by commenters, that these safeguards are inadequate to protect against cross-subsidization and discrimination by C&P." *Id.* at 9-10.

3. Reply Memorandum of FCC, *United States v. Western Electric Co., Inc.*, C.A. No. 82-0192 (D.D.C. filed Jan. 18, 1991) (Pl. Doc. App., Tab 74).

—The FCC's brief urging removal of the information services restriction states: "The Department [of Justice] has concluded that, because of regulatory constraints, 'it is unlikely that any significant cross-subsidization would occur and go undetected even where [telephone company] information services share facilities and personnel with regulated telephone services. . . .' As the Department cogently points out, moreover, information services that involve primarily the content or the processing of information rather than transmission . . . would be likely to share fewer facilities and personnel with regulated telephone service. . . . The potential for an undetected misallocation of costs is reduced when there are fewer joint and common costs." *Id.* at 41 (citations omitted).

—"[T]he Commission's decision to implement 'price cap' regulation . . . will complement its regulatory safeguards by displacing the traditional ratemaking incentives to shift costs from nonregulated activities to monopoly services. . . . Under price cap regulation, the [telephone companies] no longer

are able . . . to recover in their rates for regulated services any increased costs they have allocated to those services. Under price cap regulation, any misallocation of costs to regulated services, even if undetected, generally would not enable a [telephone company] simply to raise its rates for such services to cover the misallocated costs and thus to recoup revenues to subsidize its nonregulated services." *Id.* at 43-44 (citations omitted).

4. Brief of FCC as Amicus Curiae, *United States v. Western Electric Co.*, No. 91-5263 (D.C. Cir. filed Aug. 31, 1992) (Pl. Doc. App., Tab 78).

—On appeal, the FCC reiterated that: "[R]egulatory safeguards are adequate to minimize the possibility of unfair competition by the [telephone companies] as they enter [information] services. More importantly in the context of this remanded proceeding, the Justice Department shares the Commission's belief and told the district court so. . . . The Commission relies in particular on its *Computer III* regime of nonstructural safeguards (most of which now have been implemented) . . . and its joint cost rules governing the allocation of costs among regulated and unregulated services (which have been implemented and affirmed on review). . . . The Commision believes that its regulatory policies make it unlikely that a [telephone company] could get away with abuses under current market conditions." *Id.* at 5-6 (citations omitted).

5. *Computer III Remand Proceedings: Bell Operating Company Safegaurds and Tier 1 Local Exchange Company Safeguards*, 6 FCC Rcd 7571 ("Pl. Doc. App., Tab 76).

—"[W]e have adopted and implemented a comprehensive regulatory framework that provides an effective alternative to structural separation for pro-

tection against anticompetitive conduct." *Id.* at 7576.

—"[W]e determine that our existing cost accounting safeguards and those proposed in the *Notice* constitute a realistic and reliable alternative to structural separation to protect against cross-subsidy. . . . [A]long with our safeguards against discrimination, [these] will permit realization of the public interest benefits of integrated provision . . . of basic and enhanced services without creating substantial risks of cross-subsidization in comparison to structural separation. We also determine that the adoption of price cap regulation for the LECs [local exchange carriers] constitutes an effective complement to cost allocation, reporting, and enforcement safeguards, to reduce . . . incentives to cross-subsidize." *Id.* at 7577-78.

6. Testimony and Summary of Statement of Alfred C. Sikes Before the House Subcommittee on Economic and Commercial Law (Mar. 18, 1992) (Pl. Doc. App., Tab 11).

—Then FCC Chairman Sikes testified: "Over the past five years, new regulatory approaches have also been instituted which go far toward reducing the possibility of discriminatory conduct or anticompetitive cross-subsidization. . . . Price caps reduce the likelihood of anticompetitive cost-shifting. . . . It should be noted, moreover, that some 36 State jurisdictions—including most of the largest States—have adopted their own system of incentives-based regulation." *Id.* at 9-10.

—"Whatever might have been possible prior to the break-up of the unified Bell System, or before we instituted a comprehensive package of regulatory safeguards, the reality today is that the FCC does have effective tools, and has clearly demonstrated

both the willingness and ability to use them." *Id.* at 10.

—The accompanying summary states: "[s]ince 1987, the FCC has instituted an array of new regulatory safeguards . . . which make anticompetitive cost-shifting infeasible."

7. Transcript of Hearings Before the Subcommittee on Communications on S.1200 (Feb. 28, 1992) (Pl. Doc. App., Tab 80).

—Chairman Sikes testified: "[W]e have . . . worked hard to facilitate competition to local exchange carriers, and at present they are competitively engaged in respect to many of the high-volume customers. Now, when you are facing competition, you simply cannot do that kind of cost shifting. For the most part, these competitive access providers probably have lower cost structures to begin with, and the thought that . . . local exchange carriers can kind of rightfully shift costs of new ventures in and still be competitive is just nonsense." *Id.* at 102.

8. *Telephone Company-Cable Television Cross-Ownership Rules*, 3 FCC Rcd 5849 (1988) (Pl. Doc. App., Tab 9).

—In this notice relied on by the government here, the FCC concluded that the "ban is presumptively unnecessary" because less restrictive "nonstructural safeguards are available." *Id.* at 5854. "[W]hile telephone companies continue to have the ability to . . . engage in anticompetitive cross subsidies, safeguards perhaps analogous to those devised in *Computer III* would avoid the costs to consumers caused by a ban and . . . even if such safeguards need to be supplemented by additional protective measures, those measures could be applied in an individual Section 214 proceeding." *Id.* at 5860.

B. *The Department of Justice*

1. Reply Comments of the United States Department of Justice, *Telephone Company-Cable Television Cross-Ownership Rules*, CC Dkt 87-266 (Mar. 13, 1992) (Pl. Doc. App., Tab 6).

> —The Department's brief urging repeal of the video programming ban states: "In connection with potential discriminatory conduct aimed at other information and video gateway service providers, the Department believes that video dialtone does not require safeguards other than the equal access requirement and other requirements that are generally applicable to enhanced services. Some information service providers will be able to reach consumers through cable company facilities as well as through LECs' video dialtone facilities. Thus, the LECs will be unable to discriminate against these providers in any meaningful way. With respect to other information service providers who will be dependent on the LECs' video dialtone facilities . . . as the Department stated to the MFJ court in supporting [Bell telephone company] entry into provision of information services, the existing safeguards combined with the overall difficulty of targeting discrimination against particular information service providers are likely to prevent serious anticompetitive abuses by the LECs." *Id.* at 18-19 (footnote omitted).
>
> —"The Department similarly does not believe that additional safeguards are needed to prevent LECs from cross-subsidizing competitive elements of video dialtone by misallocating the costs involved to their regulated local telephone services. Again, for the same reasons the Department stated to the MFJ court in supporting . . . entry into provision of information services, cross subsidization in this area is not likely to succeed in lessening competition, and price reduc-

tions are more likely to reflect greater competition than predation." *Id.* at 19.

—"Thus, the Department disagrees with those commentators who argue that the Computer III rules are inadequate to protect against anticompetitive conduct in connection with LEC provision of information services . . . and therefore, will be inadequate to protect against anticompetitive conduct in connection with the provision of video dialtone." *Id.* at 20 (footnote omitted).

—The Department urged repeal of the video programming ban because: "As discussed by the Department previously . . . the anticompetitive risks associated with [Bell telephone company] provision of information services are not sufficient to justify exclusion of these carriers from an entire line of business, given the economic risks of such behavior, structural elements of the network, and the *Computer III* safeguards developed by the Commission. These conclusions hold true for LEC provision of video programming as well." *Id.* at 46 (footnote citing Department briefs urging removal of the information services restriction omitted).

2. Memorandum of the United States in Support of Motions for Removal of the Information Services Restriction, *United States v. Western Electric Co., Inc.*, C.A. No. 82-0192 (D.D.C. filed Aug. 22, 1990) (Pl. Doc. App., Tab 73).

—"The information services restriction addressed a perceived risk that, if the [Bell telephone companies] were allowed to provide information services, they would use their control over the local exchanges to impede the development of competitive markets for these new services. The belief that this risk existed was based on a series of assumptions. First, it was assumed that all information service providers

would depend on access to . . . 'bottleneck' local exchange facilities. Second, it was assumed that . . . [telephone companies] would have the practical ability as well as the incentive to discriminate against their competitors . . . and to cross-subsidize competitive information service ventures. . . . Finally, it was assumed that regulation would not prevent such conduct and the . . . conduct would have anti-competitive effects. . . . These critical assumptions have proved flawed, however. Thus, there is no continuing justification for the information services restriction." *Id.* at 14-15.

—"Regulation . . . effectively constrains . . . discrimination against information service competitors. The [FCC] has developed and implemented detailed regulations to prevent discrimination . . . against competing providers of unregulated 'enhanced services,' *i.e.*, information services." *Id.* at 22.

—"There is no substantial risk that competition would be impaired by . . . cross-subsidization. . . . Because of regulatory constraints, it is unlikely that any significant cross-subsidization would occur and go undetected even where . . . information services share facilities and personnel with regulated telephone services. Since 1987, the FCC has implemented its *Joint Cost* rules and improved its auditing procedures. The *Joint Cost* rules . . . govern the allocation of costs between regulated and unregulated . . . activities." *Id.* at 33-34.

—"Moreover, information services that involve primarily the provision of content or the processing of information rather than transmission would be likely to share fewer facilities or personnel with . . . local exchange operations than the gateway services the Court already has authorized. . . . [T]he potential for misallocation of costs in violation of allocation regulations is minimal and even more easily de-

tected by regulators where there is a relative paucity of joint and common costs between exchange operations and ventures in the new market. Thus, allowing [telephone companies] to provide currently prohibited information services should not present any significant risk of cross-subsidization." *Id.* at 34-35.

3. Reply of the United States in Support of Motions for Removal of the Information Services Restriction, *United States v. Western Electric Co., Inc.*, C.A. No. 82-0192 (D.D.C. filed Jan. 18, 1991) (Pl. Doc. App. Tab 75).

—"Objectors' contentions that the [Bell telephone companies] are likely to impede information services competition are unfounded. Regulation . . . constrains the [telephone companies] from denying information service competitors access to exchange services and facilities used by [telephone company] information services and from unreasonably discriminating in the prices, terms and conditions on which such access is provided. In addition, the antitrust laws prohibit and provide sanctions for anticompetitive conduct. . . . Further, the [telephone companies] are unlikely to attempt to lessen competition through discrimination against information service rivals because the benefits to the [telephone companies] of discrimination would be uncertain at best and the costs likely would be substantial. Substitutes . . . constrain a [telephone company's] ability to raise information service prices by discriminating in the provision of its exchange services. . . . Moreover, if discrimination were overly broad and affected nonrivals, the [telephone company] would lose exchange revenues and profits. It would likely be very difficult, if not impossible, however, for a telephone company] to target discrimination precisely." *Id.* at 4-5.

—"Finally, there is no merit to objectors' contentions that the [telephone companies] would lessen information services competition by cross-subsidization, predation or strategic entry deterrence. Regulation by the Federal Communications Commission and the states constrains misallocation of information services costs to regulated exchange services." *Id.* at 6.

4. Brief of Appellee United States of America, *United States v. Western Electric Co.*, No. 91-5263 (D.C. Cir. filed Oct. 5, 1992) (Pl. Doc. App., Tab 79).

—The Department reiterated its views on appeal: "The United States also explained why it had concluded that there would not be a significant risk of anticompetitive conduct if the information services restriction were removed. Regulation provides one important constraint. By 1991 the FCC had implemented additional safeguards against discrimination and misallocation of costs that were not in effect in 1982 or 1987." *Id.* at 25.

—"In sum, the United States' analysis of the competitive risks of removing the decree restriction and allowing the [Bell telephone companies] to provide information services took into account the *combined* effects of regulation, the variety of telephonic and nontelephonic alternatives to many information services, and the practical difficulties of targeting discrimination. . . . The United States also explained that regulation would constrain misallocation of costs of . . . information services to regulated exchange services and that even if misallocations did occur they would not be likely to result in anticompetitive predation or increased information services prices." *Id.* at 28-29 (emphasis in original).

5. Statement of James F. Rill Before the House Subcommittee on Economic and Commercial Law at 16-17 (Mar. 18, 1992) (Pl. Doc. App., Tab 13).

—Then Assistant Attorney General Rill testified: "The prophylactic concept of information services restrictions has lost its relevance. . . . The concern that the [Bell telephone companies] could restrict access to their networks was removed by the combined effect of the FCC's new *Computer III/ONA* regulatory standards, and the obvious difficulty of effectively targeting discrimination without detection. . . . As the Department explained to the court in the information services remand proceedings, the costs of such discrimination . . . would be substantial, and the benefits uncertain. As there had been no evidence in the *AT&T* case of anticompetitive practices in information services by the old Bell System, there was no record of misconduct from which one could conclude that any particular anticompetitive behavior was likely to recur." *Id.* at 19-20.

—"In the Department's view, further safeguards . . . are unnecessary in information services. . . . There is no competitive justification for prohibiting the [Bell telephone companies] from providing particular types of information services. . . ." *Id.* at 20-21.

C. *Department of Commerce*

1. Comments of NTIA, *Telephone Company-Cable Television Cross-Ownership Rules*, CC Dkt. 87-266 (Feb. 3, 1992) (Pl. Doc. App., Tab 5).

—"Generally speaking, NTIA does not believe that LEC provision of programming will necessitate the adoption of novel safeguards to prevent anticompetitive conduct apart from the requirement that LECs offer distribution facilities to unaffiliated programmers on a common carrier basis. . . . [T]he Commission's existing accounting and cost allocation rules should be sufficient to control cross-

subsidization, and open network architecture requirements should prevent discriminatory conduct. . . . *Id.* at 8, n.21 (citation omitted).

2. Department of Commerce, *The NTIA Infrastructure Report, Telecommunications in the Age of Information* (Oct. 1991) (Pl. Doc. App., Tab 4).

—"[W]e believe that the concerns. . . . expressed about LEC participation in programming either may be overstated or can be addressed through FCC safeguards. . . . Well developed safeguards can address two of the 'traditional' concerns . . . regarding cross-subsidization and also discrimination, as evidenced by the history of pole attachment access and rates. The FCC's accounting and cost allocation rules can adequately control the danger of cross-subsidization of a LEC's programming activities by its regulated operations. As we stated in a recent filing with the FCC concerning so-called 'enhanced services,' those rules are extensive and effective in controlling cross subsidy. . . ." "The increased use of incentive regulation of LECs by the FCC and the states also decreases incentives to cross-subsidize." *Id.* at 233 & n.834.

—"Concerns about discrimination, as in the case of pole attachments, can be addressed in several ways regarding pole attachments specifically. . . . [T]here is an elaborate statutory and regulatory mechanism in place to address pole attachment disputes. . . . Moreover, this issue should be less serious than in the past, since nearly 90 percent of U.S. homes have access to cable television today." *Id.* at 233 (footnote omitted).

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Alexandria Division

[Caption Omitted in Printing]

June 17, 1993

HEARING ON MOTIONS

[1] (THEREUPON, the following was heard in open court.)

THE COURT: Good morning. You may call the case and take appearances first.

THE CLERK: Civil action 90-1751-A. Chesapeake and Potomac of Virginia, et al. versus United States of America, et al.

* * * * *

[18] [MR. TRIBE:] And the reason, that I begin this way is that I think the following context, when the ban was first promulgated in 1970 and codified in '84, it's quite plain that the telephone and cable television media were distinct. That is, phone companies could not transmit video programming over their own wires. So the only way they could do what the rule prohibits, the only way they could provide video programming directly to their subscribers would be to buy or build and then operate free standing cable systems.

So, quite naturally, the FCC and Congress thought of 533(b) through this structural paragon you described, namely as a fairly standard rule against cross ownership of two distinct media facilities albeit outside the broadcasting area—

* * * * *

[20] [MR. TRIBE:] In other words, it doesn't stop you from creating a television program. It also doesn't stop you from transmitting somebody else's programming, that of some cable operator.

THE COURT: But you may not do both.

MR. TRIBE: What they want to do is both. That's what they call vertical integration.

THE COURT: In your own area?

MR. TRIBE: Your own area and it's that function which is particularly interesting.

Now, although this is—that is in Loudoun County going on. And indeed this March, C & P obtained authority for a trial of a service that would provide video programming over existing copper wires without using fiber optic, something unthinkable not long ago.

Although it's going on as recently as last year, Congress heard testimony and it appears as tab five in the defendant's document appendix, that this sort of thing probably wouldn't be doable until the year 2001.

Now, accordingly, the 1992 Senate report that the NCTA cites at page 13 of the brief, still describes 533(b) as a cross ownership rule to enhance competition, page 47 of that report. And it did so after stating [21] that and I now quote from page 18, "telephone networks are incapable of carrying video signals to home."

That's what Congress thought in 1992. So still understandably how they look at this is say what this forbids is bind the cable company. But as soon as you focus on the technology, you see 533(b) in a different light, a light that focuses one's attention on the statutes testing unobscured from illusions of technological impossibility.

* * * * *

[42] [MS. WILSON:] This is not a situation where we have spectrum scarcities. That rationale does not apply. * * *

* * * * *

[45] THE COURT: Let's go the other way. The other way might be more interesting. Let's suppose it says telephone companies can't send television programming, but they can send McLehrer—McLehrer, whatever it is, Hour. Would that be—would that be constitutional?

MS. WILSON: No, it would not be constitutional, but that's my point. The government is not making those.

THE COURT: Well, let me go on. I understand. Let's suppose then it says—it says, you may not send the news programs and you may not send sitcoms. That wouldn't pass muster either, would it?

MS. WILSON: That's right.

THE COURT: And I guess you can see I can give you a list of what's on television in 1984.

MS. WILSON: The government cannot approve whether T.V.—telephone company wants to transmit McNeil Lehrer Hour or the Home Shopping Network. * * *

* * * * *

[46] THE COURT: I guess I'm not following you. Let's go back to my hypothetical that I gave you. You started off and you were clearly correct when you said, that the statute would not pass constitutional muster if it said phone companies could use video programming but not the news programs.

And then I said, well how about if it said [47] sitcoms and news programs and you said no, that wouldn't pass muster. And you also said that it's. But let's go on with my hypothetical. And I said, well let's keep adding to that list the description of everything that's on television as of 1984, the sitcoms. You go to all dramatic programs.

In other words, you can end up with a list that if you —if you got out the T.V. Guide for 1984 you could end up with a generic list of all the stuff that's on television.

And, why wouldn't that then also not pass muster? It wouldn't, would it?

MS. WILSON: If the government was to highlight all the particular programs—

THE COURT: To say look, you may not—they went through all the T.V. Guides for 1984. They listed generic, all the things T.V. broadcasters were doing and saying instead of vague video programming is what broadcasters do they say telephone companies may not do the following on—

MS. WILSON: That was purely content base. [*sic*]

THE COURT: So, what's the difference?

MS. WILSON: The difference is that—

THE COURT: One says, you have a generic list, two or three pages. The other one you have a short sentence that summarizes it in terms of what broadcast [48] test put on. I don't see the difference.

* * * * *

[50] THE COURT: Do you think Turner would have come out the same way if instead of a provision requiring cable television system operators to carry the video signals of certain commercial and noncommercial educational television broadcast stations if it prohibited rather than permitted? You think it would come out the same way?

MS. WILSON: I'm sorry. Could you repeat the question.

THE COURT: Suppose that—do you think Turner would come out the same way if instead of a requirement [51] that they carry that required cable television system operators to carry video signals of certain commercial and noncommercial educational broadcast station if it forbad it. Wouldn't it come out differently?

Isn't Turner in that sense fundamentally different from what we're talking about here?

* * * * *

[65] MR. GILLIGAN: They're also studies that have been submitted by the NCTA and Congress received testimony on this point that while there may be competition in the short term, that in the long-term, it would simply have the replacement of one monopoly for [66] another.

* * * * *

[75] [MR. SOKLER:] * * * In fact, it is allowed to speak through the Jones Intercable microphone or anybody else's microphone.

The problem Congress identified and the reason 553(b) [*sic*] is on the book is that Congress determined that if it allowed C & P to speak through its own microphone, the risk is far too great that at the end of the day, they would have the incentive and the ability to make sure that they would be the only microphone.

* * * * *

[91] THE COURT: Let met ask you what could the government have done to achieve the goal of diversity of view point and avoiding the economic concentration? What could they have done.

MR. TRIBE: Could have repeeled, 533(b) to add competition and done it subject to the kinds of regulations that the government itself says is adequate.

* * * * *

[107] [MR. TRIBE:] And, the fact is, that nothing, nothing in any act of Congress, at least any that I have looked at, not the 1984 Cable Act of which this is a provision, not the 1992 act, includes any finding at all about why 533(b) is supposedly needed or why less restrictive alternatives would be insufficiently effective.

THE COURT: So, your view is whether or not one gives deference and how much deference one gives is not necessary to reach in this case, because they never found it. They never came up with something specific enough to [108] deserve deference.

MR. TRIBE: Of course the law itself, I mean you can say we will attribute to Congress in every case, whatever findings it takes to meet the requirements of whatever level of scrutiny is applicable, but that would empty constitutional review of all significance.

* * * * *

[119] [MR. TRIBE:] The reason I say that is it's clear as I indicated at the outset when I first stood up that as recently as 1992, Congress thought that was technological impossibility. It thought this was across ownership ban, a ban on buying the other guy's microphone.

* * * * *

[130] [MR. GILLIGAN:] Again, the—I want to get to the sort of unstated premise here of the plaintiff's argument about congressional findings. They cite no authority for the proposition that Congress cannot legislate except by reference to specific findings that it issues.

THE COURT: No, they don't say that. They say that they can do anything they want to, but they're not going to get judicial deference unless they make it unmistakably clear that there are certain findings that support it.

* * * * *

[149] THE COURT: Well, the problem with calling it a cross ownership ban is that it isn't. It's just that simple. They can all cable companies. They're not forbidden from owing cable companies. What they are forbidden from doing is furnishing video programming. That's not a cross ownership restriction. It's a restriction on what you can do, on what you can speak.. So, I have—I understand your point, but you don't—

* * * * *

THE COURT: But, they don't ban them from being [150] in the video.

* * * * *

THE COURT: They're even permitted to own a cable company.

* * * * *

[151] THE COURT: So, I think—the only point I want to make with you about calling a cross ownership is that the judiciary does nothing if it doesn't look behind words like that the executive branch uses.

You can't call a duck a duck if it doesn't walk and quack and so forth and fly like a duck. It really doesn't—it isn't what I would term a classical cross ownership provision of which there are others.

* * * * *

[188] [THE COURT] This Court does defer to legislative judgments. But, it doesn't defer to speculation. It doesn't defer to post hoc rationalization. I'm more interested in what they said at the time they passed the act than what they said after the act.

* * * * *

IN THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Record Nos. 93-2340, 93-2341

THE CHESAPEAKE AND POTOMAC COMPANY OF VIRGINIA, ET AL., PLAINTIFFS-APPELLEES

v.

UNITED STATES OF AMERICA, ET AL., DEFENDANTS-APPELLANTS

and

NATIONAL CABLE TELEVISION ASSOCIATION, INC., INTERVENOR-DEFENDANT-APPELLANT

On Appeal from the United States District Court for the Eastern District of Virginia

---

ORAL ARGUMENT
February 7, 1994

* * * * *

[15] THE COURT: I hate to interrupt you so early but aren't you regulating here what was being said by the very definition of video programming in the act. It defines video programming as programming culpable to what broadcast TV stations would do. So it seems to me that you are regulating what is said. As the District Judge said, you can get a look at the TV guide in 1984 and list everything in there and come up by that with a result.

* * * * *

[44] THE COURT: Are you saying Renton helps you or—

MR. FORREST: Absolutely.

THE COURT: But isn't that entirely different. I mean, there the same conveyor just moved out of the way and he had the same medium, dirty movies and dirty books, and presumably the same audience, and here you're forcing the telephone company to a different medium perhaps, to a different point?

* * * * *

ADMINISTRATION WHITE PAPER ON COMMUNICATIONS ACT REFORMS

* * * * *

VI. Cable-Telephone Crossownership

Although the existing cable-telephone company cross-ownership restriction of the 1984 Cable Act may have been appropriate when enacted, today it is an unnecessary and artificial barrier to competition in the delivery of video programming to American consumers and to investment in advanced local infrastructure. The Administration's proposal to remove the current restriction, coupled with its proposals to promote competition in local telephone service, will allow telephone companies and cable operators to compete in providing a full range of video, voice, and data services to the public. Such competition can promote investment that expands consumer choices and services.

To ensure that cable firms and telephone companies do not harm consumers or competition in providing these services, the Administration proposes *several safeguards* specified below, most notably requirements that most telephone companies and cable operators make transmission capacity available to unaffiliated video providers on a nondiscriminatory basis. In doing so, the Administration also seeks to protect diversity and competition in the flow of ideas, and to ensure that similarly situated firms are regulated similarly.

The Administration supports the general approach of H.R. 3636 to allow LECs to provide video programming in their telephone service areas, subject to certain conditions and safeguards. The Administration would propose somewhat different conditions and safeguards, which, however, are also designed to protect consumers and competition and prevent undue control of information content and conduit by any one firm.

Structural Separation:

- The Administration supports the approach in H.R. 3636 of requiring LECs to provide video programming through a separate affiliate, in order to prevent improper cross-subsidization and discrimination by the LEC.

- H.R. 3636 specifies many of the details of the separation requirements. The Administration proposes modifying this approach to charge the FCC with specifying the required degree of separation, subject to two basic requirements from H.R. 3636:

  —A LEC's video programming affiliate must have separate books, records, and accounts; and

  —Any contract or agreement between a LEC and its affiliate (1) must be pursuant to regulations adopted by the FCC, (2) must be on a fully compensatory and auditable basis, (3) must be without cost to the LEC's telephone service ratepayers, (4) must be filed with the FCC, and (5) must adhere with rules that will enable the FCC to assess the compliance of any transaction with its rules.

- The Administration supports the approach of H.R. 3636 in permitting the FCC to modify separation requirements for small and rural LECs at any time. H.R. 3636 would allow the FCC to modify separation requirements for other LECs beginning 5 years after enactment. The Administration proposes reducing that waiting period to 2 years, to provide greater regulatory flexibility in the face of changing conditions.

Nondiscriminatory Access Obligations:

- In order to promote competition and diversity in the flow of ideas, H.R. 3636 would require a LEC that provides video programming to subscribers in its service area to establish a "video platform," based on the

FCC's current "video dialtone" rules, and make it available to unaffiliated programmers on nondiscriminatory terms. The Administration supports this general approach, with some modifications.

- H.R. 3636, by its terms, would require that the rates for the platform be nondiscriminatory. The Administration proposes specifying that LEC provision of the video platform will be subject to all requirements of Title II of the Communications Act.
- H.R. 3636 appears to require a LEC to afford nondiscriminatory access to its video platforms only when it carries "affiliated" video programming (*i.e.*, programming in which the LEC has an ownership interest). The Administration proposes requiring a LEC to afford unaffiliated programmers nondiscriminatory access to its video platform whenever the LEC carries video programming.
- H.R. 3636 would require the FCC to limit the number of channels on a LEC's video platform that can be occupied by its video programming affiliate (that limit can be no lower than 25% of the platform's capacity). The Administration proposes to authorize the FCC to impose such a limit and give the FCC discretion in selecting what the limit should be.
- The Administration proposes to permit the FCC to modify any of the foregoing requirements for small and rural LECs. H.R. 3636 contains no similar provision for small, non-"rural" LECs.
- The Administration supports allowing the FCC to modify the definition of "video platform" beginning 1 year after enactment. H.R. 3636 contains no such provision.
- The Administration proposes to direct the FCC to adopt regulations, within 1 year of enactment, that would require cable operators to offer nondiscrimina-

tory access to channel capacity on their systems for unaffiliated programmers, except when technology, costs, and market conditions would make such offering inappropriate. H.R. 3636 requires that the FCC study whether to impose such obligations and report to Congress within 2 years after enactment.

Anti-Buyout Provisions:

- To protect competition in the provision of communications and information services and to further the flow of ideas, the Administration supports limiting a LEC's ability to enter the video services market via acquisition of cable systems operating in its telephone service area. The Administration proposes to limit cable companies' ability to acquire LECs providing local telephone service in the cable companies' franchise areas.
- The Administration supports the provisions of H.R. 3636 permitting in-region acquisitions occurring in rural areas and for joint LEC/cable operator use of the cable "drop wire." The Administration proposes eliminating the provision of H.R. 3636 that would permit a LEC/cable acquisition if the number of households served by the cable systems acquired constituted less than 10% of all households in the telephone service areas of the acquiring LEC and its affiliates.
- H.R. 3636 would also authorize the FCC to waive the anti-buyout policy at any time under certain conditions. The Administration proposes authorizing the FCC to change the policy by rule, or to grant waivers on a case-by-case basis, beginning 5 years after enactment, if it determines that such action would be in the public interest. Such acquisitions would, however, remain subject to the antitrust laws.

Franchise Obligations:

- The Administration supports the general approach in H.R. 3636 of removing some requirements of the Cable

Act for the LEC's video programming affiliate and any other user of the LEC's video platform, while maintaining others, such as must carry, retransmission consent, the provision of public, educational, and governmental channels, and others designed to protect consumers.

- To promote symmetric regulation of similarly-situated firms, the Administration proposes to authorize the FCC to remove some Cable Act requirements (most notably, the requirement to have a cable franchise) for cable systems that offer nondiscriminatory access substantially similar to that required by LECs by the bill, while maintaining the overall Cable Act regulatory structure. H.R. 3636 has no comparable provision.

Rural Exemption:

- H.R. 3636 states that provisions concerning the video programming affiliate, the video platform, provision of affiliated programming, and the ban on acquisitions do not apply to LECs offering video programming in rural areas. The Administration proposes to authorize the FCC to modify those provisions for such LECs.

* * * * *

FEDERAL COMMUNICATIONS COMMISSION

Washington

[FCC Logo]

OFFICE OF
THE CHAIRMAN

Statement of

Reed E. Hundt
Chairman
Federal Communications Commission

Before the

Subcommittee on Telecommunications and Finance
Committee on Energy and Commerce
United States House of Representatives

on

H.R. 3636, the "National Communications Competition and Information Infrastructure Act of 1993"

and

H.R. 3626, the "Antitrust Reform Act of 1993" and the "Communications Reform Act of 1993"

January 27, 1994

* * * * *

III. Competition In the Multichannel Video Distribution Market Entry

The market for multichannel video distribution is dominated today by cable television providers. This market should be opened to more competition. The existing prohibition that bars telephone companies from providing video programming to customers in their telephone service areas should be repealed. It is very appropriate, therefore, that H.R. 3636 would remove this restriction and allow telephone companies to compete with cable companies in providing one-way and interactive video services.

Direct, facilities-based competition between cable and telephone companies will produce substantial benefits for the American public. Competition in this market will spur the deployment of advanced technologies that are capable of delivering the full range of services that customers demand. These services include not only entertainment services, but also the growing number of educational, health, and social services that are accessible over broadband technologies.

In addition, competition in this market can be expected to produce the same positive results for consumers that we have seen in other markets for telecommunications services that have undergone the transformation from monopoly to competition: technological and service innovation, lower prices, and responsiveness to consumer tastes. Telephone company entry also will expand the electronic marketplace of ideas by creating new outlets for video service providers.

As you know, Mr. Chairman, the FCC already has taken steps to enhance competition in the multichannel video distribution market. Within a few months, U.S. consumers will be able to receive programming from a Direct Broadcast Satellite service. This service is capable of delivering scores of channels of programming directly to homes and offices equipped with 18-inch dishes.

In 1992, the Commission authorized telephone companies to offer video dialtone service within their operating territories through a basic "video platform" that provides non-discriminatory access to multiple video programmers. Since these rules were enacted, four telephone companies have received authorization from the Commission to construct and operate video dialtone systems for purposes of testing technology and evaluating consumer demand for the services offered.

Elimination of the existing cross-ownership restriction should stimulate new telephone company investment in facilities that are capable of delivering video and advanced telecommunications services. Consumers should be the beneficiaries of the expanded choices that facilities-based competition in this market will foster.

Safeguards

Adequate safeguards must be in place to ensure vigorous and effective competition between telephone companies and cable companies. In a report to Congress in 1992 that recommended removal of the prohibition against telephone company entry into video programming, the FCC cautioned that certain restrictions might be necessary to prevent potential anticompetitive practices, including possibly a requirement that a telephone company provide video programming to end users through a separate affiliate. H.R. 3636 would impose this restriction as an initial requirement and I support that approach.

The bill also would require a carrier to make available up to 75 percent of its capacity to unaffiliated video programmers upon request. I share the authors' concern that unaffiliated video programmers must have adequate access to the video platform to ensure delivery of their video programs and services. I also agree that the Commission should monitor closely the impact of this requirement during the first two years after enactment. Given the pace of change, it might be appropriate to give the

Commission the authority to modify the reserve requirement if an investigation shows that it is no longer in the public interest. Generally, the Commission should have the discretion needed to adjust its policies to achieve the overall goal of promoting competition. Similarly, while I support the bill's proposal to require the FCC to examine whether cable systems should be required to provide nondiscriminatory access to a video platform (just as telephone companies would be required to do), the FCC might be given the authority to adopt such a requirement, if its investigation shows that such enhanced access to cable systems would be in the public interest.

Mr. Chairman, I would like to offer one other suggestion before turning to H.R. 3626. The removal of barriers to entry into the local telephone market and the video distribution market as proposed by H.R. 3636 likely will accelerate the trend toward convergence of the markets for all telecommunications services. This trend suggests that, over time, traditional regulatory distinctions between telephone and cable companies will become increasingly blurred and outdated. It also suggests that serious consideration should be given to a third regulatory paradigm, one that would permit the FCC to regulate these emerging diversified service providers under a single, integrated system, rather than partially under Title II and partially under Title VI. As I will discuss later in my testimony, the Administration has suggested a possible third regulatory model to address the emergence of this new type of service provider.

In general, we should aspire not to impose unnecessary or duplicative regulations that increase consumer rates and hinder the development of fully competitive markets for telephony and video services. I hope this Subcommittee, therefore, will consider granting the Commission the regulatory flexibility necessary to permit it to refrain from imposing obligations that would undermine, rather than foster, the continued development of competitive markets for telephone and video services.

The Commission's exercise of its limited existing forbearance authority under Title II has produced substantial benefits—the permissive detariffing policy contributed to the development of a competitive long distance market and more recently to the emergence of competition for access services. Moreover, Congress last year recognized the importance of broad forbearance authority in facilitating the emergence of competitive telecommunications markets when it granted the Commission the discretion to forbear from imposing on commercial mobile service providers any Title II requirements except those contained in Sections 201 (non-discrimination), 202 (just and reasonable rates) and 208 (resort to complaint process).

* * * * *

[DoJ LOGO]

DEPARTMENT OF JUSTICE

STATEMENT OF

ANNE K. BINGAMAN
ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE THE

SUBCOMMITTEE ON TELECOMMUNICATIONS
AND FINANCE
COMMITTEE ON ENERGY AND COMMERCE
U.S. HOUSE OF REPRESENTATIVES

CONCERNING

NATIONAL COMMUNICATIONS COMPETITION
AND INFORMATION INFRASTRUCTURE ACT
H.R. 3636

AND

THE ANTITRUST REFORM ACT
H.R. 3626

PRESENTED ON

JANUARY 27, 1994

* * * * *

The Administration also strongly endorses the provisions in H.R. 3636 that would permit existing cable and telephone companies to offer both video and telephonic services in the same geographic areas. The Administration also endorses the general thrust of the provisions in the legislation that prohibit telephone and cable television companies from acquiring each other within the same territory. It is crucial that public policy promote competition between methods for delivering telecommunications services.

* * * * *

TESTIMONY OF LARRY IRVING ASSISTANT SECRETARY FOR COMMUNICATIONS AND INFORMATION U.S. DEPARTMENT OF COMMERCE

ON

TELECOMMUNICATIONS REFORM LEGISLATION

BEFORE THE SUBCOMMITTEE ON ECONOMIC AND COMMERCIAL LAW
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

JANUARY 26, 1994

* * * * *

CABLE TELEVISION-TELEPHONE COMPANY CROSS-OWNERSHIP

The Administration supports repeal of the current cable television-telephone company cross-ownership restriction in the 1984 Cable Act. We believe that telephone companies should be allowed to provide video services in their local exchange areas, subject to effective safeguards to protect consumers and competition.

* * * * *

TESTIMONY OF LARRY IRVING
ASSISTANT SECRETARY FOR
COMMUNICATIONS AND INFORMATION
U.S. DEPARTMENT OF COMMERCE

ON

TELECOMMUNICATIONS REFORM LEGISLATION

BEFORE THE SUBCOMMITTEE ON
TELECOMMUNICATIONS AND FINANCE
COMMITTEE ON ENERGY AND COMMERCE
HOUSE OF REPRESENTATIVES

JANUARY 27, 1994

* * * * *

The Administration supports repeal of the current cable television-telephone company cross-ownership restriction in the 1984 Cable Act. We believe that telephone companies should be allowed to provide video services in their local exchange areas, subject to effective safeguards to protect consumers and competition. The Administration is proposing two critical safeguards.

First, consistent with the approach of H.R. 3636, telephone companies will be required to make channel capacity available to unaffiliated video program providers on a nondiscriminatory basis, while providing video programming through separate affiliates. This requirement should create market opportunities for competing providers of video services, thereby reducing prices and expanding the diversity of programming and services available to telephone viewers.

Second, the Administration proposes to prohibit telephone companies from acquiring cable systems located in the companies' local exchange areas for at least five years. This will deter premature and potentially anticompetitive mergers between telephone companies and their most likely competitors, existing cable companies. The Administration proposal allows fewer exemptions of telephone company buyouts of cable firms than H.R. 3636. However, telephone companies operating in rural areas will be exempted, because these markets may be unable to support more than one carrier.

The need for this second safeguard may wane in the coming years as markets change, so the Administration has added to it a flexible element. We propose to authorize the FCC to begin proceedings that could allow such acquisitions five years after the date of legislative enactment, if certain conditions, to be established by the Commission, are met. An example of such a condition might be the presence of sufficient competition in the telephone company's service area in the delivery of telephone or cable services.

Of course, any telephone company/cable system acquisition would be subject to the antitrust laws in the same manner as an acquisition in any other industry.

The Administration's proposals on the "video platform" are similar to those in H.R. 3636, except that the Administration's proposal makes clear that the platform will be subject to all requirements of Title II, not simply the requirement that rates be nondiscriminatory, as H.R. 3636 appears to contemplate. The Administration proposal also requires a carrier to afford nondiscriminatory access to the video platform whenever it offers video programming.

* * * * *

SUPREME COURT OF THE UNITED STATES

No. 94-1893

UNITED STATES, FEDERAL COMMUNICATIONS COMMISSION
JANET RENO, ATTORNEY GENERAL, PETITIONERS

v.

CHESAPEAKE AND POTOMAC TELEPHONE COMPANY
OF VIRGINIA, ET AL.

ORDER ALLOWING CERTIORARI

Filed June 26, 1995

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fourth Circuit is granted. This case is consolidated with No. 94-1900, *National Cable Television Association, Incorporated v. Bell Atlantic Corporation, et al.* and a total of one hour is allotted for oral argument.

June 26, 1995

SUPREME COURT OF THE UNITED STATES

No. 94-1900

NATIONAL CABLE TELEVISION ASSOCIATION, INCORPORATED, PETITIONER

v.

BELL ATLANTIC CORPORATION, ET AL.

ORDER ALLOWING CERTIORARI

Filed June 26, 1995

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fourth Circuit is granted. This case is consolidated with No. 94-1893, *United States Federal Communications Commission and Janet Reno, Attorney General v. Chesapeake and Potomac Telephone Company of Virginia, et al.* and total of one hour is allotted for oral argument.

June 26, 1995

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Nos. 94-1996, 94-1900

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, *et al.*,
Petitioners,

v.

CHESAPEAKE AND POTOMAC TEL. CO. OF VIRGINIA, *et al.*,
Respondents.

NATIONAL CABLE TELEVISION ASSOCIATION, INC.,
Petitioner,

v.

BELL ATLANTIC CORPORATION, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF FOR PETITIONER NATIONAL CABLE TELEVISION ASSOCIATION, INC.

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QUESTION PRESENTED

Whether the court of appeals incorrectly held that 47 U.S.C. § 533(b)—enacted in 1984 as a presumptive bar on the local telephone monopolies' entering the cable television business in their telephone-service areas, but allowing entry where there is good cause—is invalid under the First Amendment.

PARTIES TO THE PROCEEDING

The National Cable Television Association, Inc., petitioner in No. 94-1900, was an appellant in the court of appeals, along with the United States of America, Federal Communications Commission, and Janet Reno, as Attorney General of the United States, who are petitioners in No. 94-1893. The appellees in the court of appeals, who are respondents here, are the Bell Atlantic Corporation and its relevant subsidiaries: The Chesapeake and Potomac Telephone Company of Virginia; The Chesapeake and Potomac Telephone Company; C&P Telephone Company of Maryland; The Chesapeake and Potomac Telephone Company of West Virginia; the Diamond State Telephone Company; The Bell Telephone Company of Pennsylvania; New Jersey Bell Telephone Company; and Bell Atlantic Video Services Company.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

No. 94-1893

UNITED STATES OF AMERICA, *et al.*,
Petitioners,

v.

CHESAPEAKE AND POTOMAC TEL. CO. OF VIRGINIA, *et al.*,
Respondents.

No. 94-1900

NATIONAL CABLE TELEVISION ASSOCIATION, INC.,
Petitioner,

v.

BELL ATLANTIC CORPORATION, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF FOR PETITIONER NATIONAL CABLE TELEVISION ASSOCIATION, INC.

Petitioner National Cable Television Association (NCTA) seeks reversal of the decision of the United States Court of Appeals for the Fourth Circuit (Pet. App. 1a-45a) holding that 47 U.S.C. § 533(b)—the telephone cable cross-ownership statute—is invalid under the First Amendment.[1]

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[1] Pursuant to Rule 29.1 of the Rules of this Court, petitioner NCTA states that it has no parent company and no subsidiaries.

"Pet. App." refers throughout this brief to the appendix to NCTA's petition, in No. 94-1900.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-45a) is reported at 42 F.3d 181. The opinion of the district court (Pet. App. 46a-93a) is reported at 830 F. Supp. 909.

JURISDICTION

The judgment of the court of appeals was entered on November 21, 1994. Pet. App. 3a. Timely petitions for rehearing were denied on January 18, 1995. Pet. App. 94a-96a. Chief Justice Rehnquist extended the time for filing a petition for certiorari to May 18, 1995. Pet. App. 97a. The government's petition was filed on May 17, 1995, and NCTA's petition was filed on May 18, 1995. This Court granted the petitions, and consolidated the cases, on June 26, 1995. JA 386-87.

STATUTORY PROVISION INVOLVED

Section 533(b) of Title 47, United States Code, provides:

> (1) It shall be unlawful for any common carrier, subject in whole or in part to subchapter II of this chapter, to provide video programming directly to subscribers in its telephone service area, either directly or indirectly through an affiliate owned by, operated by, controlled by, or under common control with the common carrier.
>
> (2) It shall be unlawful for any common carrier, subject in whole or in part to subchapter II of this chapter, to provide channels of communications or pole, line, conduit space, or other rental arrangements, to any entity which is directly or indirectly owned by, operated by, controlled by, or under common control with such common carrier, if such facilities or arrangements are to be used for, or in connection with, the provision of video programming directly to subscribers in the telephone service area of the common carrier.

(3) This subsection shall not apply to any common carrier to the extent such carrier provides telephone exchange service in any rural area (as defined by the Commission).

(4) In those areas where the provision of video programming directly to subscribers through a cable system demonstrably could not exist except through a cable system owned by, operated by, controlled by, or affiliated with the common carrier involved, or upon other showing of good cause, the Commission may, on petition for waiver, waive the applicability of paragraphs (1) and (2) of this subsection. Any such waiver shall be made in accordance with section 63.56 of title 47, Code of Federal Regulations (as in effect September 20, 1984) and shall be granted by the Commission upon a finding that the issuance of such waiver is justified by the particular circumstances demonstrated by the petitioner, taking into account the policy of this subsection.

STATEMENT

The telephone-cable cross-ownership statute at issue, 47 U.S.C. § 533(b), imposes a presumptive bar (paragraphs (1) and (2)), subject to waiver for good cause (paragraph (4)), on integration by the local telephone monopolists into the business of selling cable television service in their local telephone-monopoly regions. The statute addresses the well-recognized, structural economic problems that arise when a regulated monopolist (telephone) enters a closely related unregulated (or less regulated) business (cable). Such integration always generates the incentive, and often provides substantial opportunities, for the monopolist to engage in cross-subsidization, discriminatory self-preference, and other conduct that simultaneously enables it to evade regulation's restraint on its full exploitation of its monopoly ratepayers and, at the same time, to distort, raise prices in, or even gain power in the newly entered market. The incentives to engage in such conduct are particularly great

if the newly entered business is itself a threat to the basic monopoly, as cable is to telephony, so that unfair competition in the entered market may reinforce and protect the monopoly. In these circumstances, it is well recognized that restricting entry may be pro- rather than anticompetitive. *See* pages 8-12, 36-40, *infra*.

Section 533(b) was enacted in 1984, based on a Federal Communications Commission rule adopted in 1970, to address this situation. How serious the problem is and how it should be addressed require a determination whether the anticompetitive risks outweigh the normal procompetitive benefits of allowing entry. And in evaluating the risks and selecting a remedy, the policymaker's basic choice between a structural bar and regulatory oversight focuses ultimately on an assessment of administrative standard-setting and monitoring as a means of controlling cross-subsidy and discrimination: how effective such regulatory controls would likely be, how costly they would be to implement, and how much error should be tolerated. In the telephone-cable situation, these assessments have been made, and the balance has been struck, differently at different times by different policymakers.

Section 533(b), in paragraphs (1) and (2), chooses simple structural separation of the telephone and cable businesses as the presumptively needed means of addressing the undoubted economic problems, and thus fostering and preserving the presence of two wire networks, rather than one wire network, for electronic communications into the home. Paragraph (4) of the statute also allows waivers for "good cause." And the Commission, exercising its authority under paragraph (4), recently concluded that the balance of risks and benefits has now sufficiently changed that the policies behind Section 533(b) are best fulfilled through regulatory oversight under certain conditions rather than structural separation. Pet. App. 103a-121a; *id.* at 105a & n.4.[2]

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[2] Congress is considering telecommunications legislation that would replace Section 533(b) with narrower, regulatory constraints

I. Administrative and Statutory Background

A. *Administrative History.* In the late 1960s, the Federal Communications Commission examined well-documented telephone company efforts to prevent the development of an independent cable television industry, then in its infancy. In 1968, the Commission required telephone companies to obtain certification, under 47 U.S.C. § 214, before constructing, acquiring, or operating video transmission facilities. *General Tel. Co. of California*, 13 F.C.C.2d 448 (1968), *aff'd, General Tel. Co. of California v. FCC*, 413 F.2d 390 (D.C. Cir.), *cert. denied*, 396 U.S. 888 (1969). The FCC noted that "[b]y reason of its control over utility poles, or other local advantages resulting from its status as an existing common carrier in the community, the telephone company is in a position to preclude or to substantially delay an unaffiliated CATV system from commencing service and thereby eliminate competition." *Id.* at 463. The Section 214 process subsequently revealed that telephone companies had in fact discriminated in favor of their affiliates and "otherwise improperly extended their existing monopoly in the telephone field to CATV services." *Applications of Telephone Companies for Section 214 Certificates*, 34 Fed. Reg. 6290, 6290-91 (1969).

In 1969, therefore, the Commission proposed to address the problems of "undue concentration of control of CATV systems by telephone companies," "anticompetitive practices" by telephone companies, and "possible unfair competitive advantages" of telephone companies in the cable business, such as the ability of telephone companies to "subsidize the cost of construction and services required by their affiliates out of revenues derived by the telephone companies from their other services." *Id.* at 6292. In 1970, the Commission concluded that the proper response was a rule that presumptively barred

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on telephone company entry into the cable business. Both the House and Senate have enacted bills containing such provisions. The legislation is expected to go to conference soon.

telephone companies from providing cable television service within their local exchange areas, except upon grant of a Commission waiver. *Applications of Telephone Companies for Section 214 Certificates*, 21 F.C.C.2d 307, *recons. in part*, 22 F.C.C.2d 746 (1970), *aff'd, General Tel. Co. of the S.W. v. United States*, 449 F.2d 846 (5th Cir. 1971). The Commission rule, which from the beginning has provided for waivers of the prohibition upon a showing of "good cause" (and in other specified circumstances), is codified in its current form at 47 C.F.R. §§ 63.54-.56.

In adopting its rule, the Commission explained that "the prevention of undesirable concentration of control of communications media has always been of great concern" (21 F.C.C.2d at 328) and noted the Justice Department's conclusion that telephone companies were "seeking to extend their regulated telephone monopoly into the areas of CATV [cable television] and broadband coaxial cables, primarily to assure themselves of control over the services broadband coaxial cable will perform in the future" (*id.* at 324).[3] The Commission pointed specifically to telephone companies' ability, by virtue of their "monopoly position," to discriminate against cable operators seeking

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[3] The Eighth Circuit later described and quoted the Justice Department's 1970 comments: "The Department of Justice early recognized that CATV operators and telephone companies were both competitors and potential competitors. In 1970 it stated: . . . 'independent CATV operators and the telephone companies were present and direct competitors in the construction of CATV distribution systems. . . . The telephone companies have made it clear that they regard cable operators as potential competitors for a variety of services.'" *TV Signal Co. of Aberdeen v. AT&T*, 617 F.2d 1302, 1308-09 (8th Cir. 1980) (quoting Justice Department comments to FCC). The Eighth Circuit added: "in the present case there exists evidence that the purpose of Bell's exclusion policy [limiting use of poles] was to coerce operators to utilize Bell's own equipment, thus yielding greater revenue to Bell, and deterring independent operators from entering the CATV and potential broadband communications fields." *Id.* at 1309 n.7.

essential access to telephone poles and underground conduits for their cable television wires. *Ibid.* The Commission also noted evidence that telephone companies with cable affiliates "can subsidize those affiliates with revenues obtained through telephone company operations." *Id.* at 311.

In the years following its adoption, the Commission applied the rule and reaffirmed its role in restraining the local telephone company's "potential, by reason of its monopoly position in the community, to discriminate against CATV operators who desire to provide their own distribution facilities." *Better T.V., Inc. of Dutchess County*, 31 F.C.C.2d 939, 957, 966-67 (1971), *modified on other grounds*, 34 F.C.C.2d 142 (1972); *see, e.g., California Water & Tel. Co.*, 40 F.C.C.2d 1138 (1973); *Telephone Co. Affiliation with CATV Systems*, 41 F.C.C.2d 938 (1973). In 1978, the Commission reiterated that its 1970 rulemaking had considered various issues, including "the prevention of potential favoritism by a telephone company towards an affiliated cable television system either in the methods of establishing it, or by subsidizing the affiliate to the detriment of telephone subscribers," as well as the concentration of control from a telephone-cable combination. *Cross Ownership Rules*, 69 F.C.C.2d 1097, 1099 n.5 (1978). The Commission also made clear, based on its recognition that a single integrated voice-video network was now in the offing (*id.* at 1106-08), that its consideration of applications for waiver based on "good cause" would "permit explicit consideration of recent technological developments" and of "the nature and extent of reasonably foreseeable economies from joint or integrated operation," while guarding against "potentially adverse cross-subsidization between a carrier's telephone and cable television business." *Id.* at 1111.[4]

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[4] The Commission subsequently ruled that "good cause" waivers were not limited to those circumstances where independent cable

In 1981, after Congress addressed part of the problem through the Pole Attachments Act,[5] the Office of Plans and Policy of the Commission undertook at the Commission's direction a comprehensive analysis of the cross-ownership rule (among other matters) and produced an extensive report, *FCC Policy on Cable Ownership: A Staff Report*, reviewing and ultimately reaffirming the need for the in-region presumptive bar. JA 31-78 (excerpts). The report explained that permitting cross-ownership might have economic and technological benefits (JA 43-52), while noting that technological benefits may be grounds for waiver (JA 50 & 41 n.4). The report then explained why there were still overriding risks.

"The disadvantages of crossownership largely derive from the fact that telephone companies are regulated exclusive franchise monopolists in their local area." JA 52. That fact meant that integration into cable can enable the telephone company "partially to avoid rate-of-return regulation on its telephone service . . . by attributing costs to the regulated telephone division and revenues to an unregulated cable division," with the result that telephone ratepayers would be exploited by higher prices and the cable markets distorted through subsidized entry. *Ibid.*; *id.* at 54-58. Such cross-subsidization would be "harder to control if cable and telephone system costs are incurred in one area for the same types of equipment, or are to some extent joint or common." JA 57 (foot-

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operation is impossible but would be available upon a showing of "[c]lear and substantial economies in construction or operation." JA 41 n.4; *Sugar Land Report and Order*, 76 F.C.C.2d 230, 235-36 (1980); *see* JA 43 n.7.

[5] Congress enacted the Pole Attachments Act of 1978 to "regulate the rates, terms, and conditions for pole attachments." 47 U.S.C. § 224(b)(1). The Act leaves considerable room for costly dispute over such terms and conditions, however, and does not, in any event, guarantee access in the first place. *See FCC v. Florida Power Corp.*, 480 U.S. 245, 251 n.6 (1987).

note omitted).[6] The telephone companies have a uniquely strong incentive to engage in such conduct with respect to cable because doing so can help forestall the competitive threat that cable presents to the telephone business itself, whether for voice or data carriage or for bypass of the local exchange for access to long-distance carriers. JA 53, 58-60; *id.* at 59 ("cable has more potential to provide telephone-like services in the near future than does any other carrier"). These reasons, the report concluded, "are sufficient to overcome the social presumption in favor of allowing unrestricted crossownership." JA 63 (footnote omitted).[7]

The 1981 report extensively discussed the possibilities of addressing the "problems of crossownership directly, through regulation." JA 67; *id.* at 67-78. Having noted the intractable problem of cost allocation (*see* note 6, *supra*), the report explained the substantial reasons to doubt the effectiveness of regulatory efforts, at that time and possibly in the long run, to prevent discrimination and cost-shifting. *Ibid.* The report concluded that "regulatory tools cannot now solve the problems involved in crossownership between cable and telephone facilities." *Id.* at 75. These conclusions were the most comprehensive and recent analysis of the specific telephone-cable issue before Congress acted in 1984. *See also Telephone Co.-Cable Television Cross-Ownership Rules*, 84 F.C.C.2d 335 (1981) (initiating proceeding to reconsider the cross-ownership rule).

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[6] "One of the most difficult aspects of telephone regulation is the assignment of costs to their causes. Cable and telephone systems share a certain amount of capital equipment; allocating shared costs between these capital accounts on the basis of actual cost causation will be difficult or impossible." JA 57 (footnote omitted).

[7] The report also noted evidence that pole-access problems had continued despite the 1978 statute, but it concluded that the "problem of pole access does not by itself justify banning crossownership." JA 62.

B. *The Bell System Breakup.* In 1982, the government and AT&T announced their agreement, as a settlement of the 1974 monopolization case, to break up the Bell System so as to separate the local monopoly businesses (now the Bell Operating Companies, or BOCs, including Bell Atlantic) from the competitive businesses (which remained with AT&T). *See United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd*, 460 U.S. 1001 (1983). Substantial evidence had been developed by the government that the Bell System had extensively used its local monopoly power to impair or to forestall competition in related markets, including long-distance, equipment, and even cable. *See, e.g.*, JA 253, 255-56, 260-61. And the consent decree that settled the lawsuit not only broke apart the existing Bell System but barred the local monopolies from entering certain related competitive businesses (long-distance, equipment manufacturing, and "information services," the last including cable television, *see* JA 219) that, because of large common costs or opportunities for discrimination, presented great dangers from what a congressional report the prior year had succinctly described as "the incentives of a regulated/unregulated company." [8]

The economic evils targeted by the ban on regulated/unregulated integration were explained by the United States in its defense of the breakup decree. "[T]he BOCs' control over essential local exchange facilities will give them both the power and incentive to disadvantage competitors in related markets through cross-subsidization and

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[8] *Telecommunications in Transition: The Status of Competition in the Telecommunications Industry* ("Wirth Report"), Report by Majority Staff of Subcomm. on Telecomm., Consumer Protection, and Finance of House Comm. on Energy and Commerce, 97th Cong., 1st Sess. 58 (1981). This report, chapter 4 of which provides a concise description of the economic dangers of the regulated telephone monopolists' entry into related businesses, was produced by the same House subcommittee that was principally responsible for the 1984 Cable Act.

discriminatory actions." *United States' Response to Public Comments*, 47 Fed. Reg. 23,320, 23,336 (1982); *id.* at 23,323. Moreover, "regulatory mechanisms . . . are not sufficient to control the long term incentives and abilities the BOCs would have to disadvantage competitors in related markets. At the heart of the government's case in *United States* v. *AT&T* was the failure of regulation to safeguard competition in the face of the powerful incentives and abilities of a firm engaged in the provision of both regulated monopoly and competitive services." *Id.* at 23,336.[9]

As to cross-subsidy: "the FCC struggled for more than 20 years unsuccessfully to solve the problem of allocating common costs between competitive and non-competitive services"; "[t]here is simply no single correct formula for [such] allocation"; and in any event, "the possession by the BOCs of relevant cost information, the extent of common costs, and the high degree of discretion in the treatment of such costs enjoyed by the BOCs, would very likely frustrate meaningful regulatory oversight, especially in light of strong incentives on the part of the BOCs to do so." *Ibid.* As to discrimination: "this is a subject that has preoccupied regulation for more than a decade with little success"; and regulation is not likely, in such a "technologically dynamic industry," to be "capable of detecting or preventing the very subtle forms of discrimination that would be available to the BOCs." *Ibid.* *See id.* at 23,337. The government also explained that, while

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[9] "If the BOCs, as rate base/rate of return regulated monopolists, were permitted to enter related competitive markets, they would have the means and incentive to disadvantage their competitors by cross-subsidization and discrimination in the terms and conditions of access to the local exchange. Neither of these problems has thus far proven amenable to successful regulatory solution. Indeed, the very basis for divestiture is that the anticompetitive problems inherent in the joint provision of regulated monopoly and competitive services are otherwise insoluble." 47 Fed. Reg. at 23,336.

the dangers were attenuated where few common costs or opportunities for discrimination existed (*id.* at 23,335), the dangers were greatest, and least amenable to regulatory control, precisely when the same switching equipment was used for the provision of both regulated telephone service and some other service (*id.* at 23,338-39).

C. The 1984 Cable Act. Against this background, Congress enacted Section 533(b)—the telephone-cable cross-ownership statute—as part of the comprehensive 1984 Cable Act.[10] With only a few changes of language, the statute codified the Commission's rules presumptively barring the local telephone companies from entering the cable business inside their telephone-service regions (paragraphs (1) and 2)).[11] Congress also included a provision (paragraph (4)) authorizing Commission waivers

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[10] We note two points of terminology. First, although Bell Atlantic has throughout this proceeding insisted that Section 533(b) is not really a "cross-ownership" rule, the Fourth Circuit recognized that this was a "merely semantic" point, since the analysis does not turn on labels. Pet. App. 9a n.7. We follow the familiar label, reflecting the facts that the provision applies by its terms to telephone company ownership of a cable *business*, Congress included it among the "ownership restrictions" set forth in Section 533, and "cross-ownership" is the term that was used by the legislative history (*e.g.*, H.R. Rep. 934, 98th Cong., 2d Sess. 55 (1984)) and has always been used by the Commission.

Second, we use the term "cable" as a shorthand for the (narrower) statutory term "video programming." The statute has been construed by the Commission and the D.C. Circuit as applying only when a telephone company provides video programming over a "cable system." *American Scholastic TV Programming Found. v. FCC*, 46 F.3d 1173 (D.C. Cir. 1995).

[11] Consistent with the statute's underlying purposes, the Commission has indicated that Section 533(b) applies, not to all companies that are in any way in the "telephone" business, but only to local exchange carriers—*i.e.*, "traditional landline local exchange telephone companies" providing "ubiquitous, interconnected switched service" over "bottleneck facilities." *In re Application of Teleport Communications—New York*, 7 F.C.C.R. 5986, 5988, *recons. denied*, 8 F.C.C.R. 5464 (1992), *vacated as moot*, No. 92-1521 (D.C. Cir. Oct. 11, 1994).

upon a showing of "good cause" and directed the Commission to grant such a waiver where "justified by the particular circumstances demonstrated by [an applicant], taking into account the policy of this subsection."[12]

The legislative history of these provisions is not elaborate. At hearings in 1982, the Senate received testimony from both cable and telephone industry witnesses reciting the concerns about discrimination and cross-subsidization. *Cable Television Regulation: Hearings on S. 2172 before the Subcomm. on Communications of the Sen. Comm. on Commerce, Science, and Transportation*, 97th Cong., 2d Sess. 107-08, 344, 386-90, 590, 623 (1982). And there was debate about whether the whole issue should be left to the continuing authority of the Commission, as the Commission's chairman urged. *Id.* at 97. In the 98th Congress, the Senate enacted a cable bill that did not contain a provision codifying or otherwise addressing telephone-cable cross-ownership. *See* S. Rep. 67, 98th Cong., 1st Sess. 34 (1983); 129 Cong. Rec. 15451-54 (1983).

The House, which substantially wrote what became the 1984 Cable Act, added what is now Section 533(b). The House Report recites simply the congressional aim "to prevent the development of local media monopolies, and to encourage diversity of ownership of communications outlets." H.R. Rep. 934, 98th Cong., 2d Sess. 55

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[12] As part of Section 533, Congress included, in addition to the telephone-cable cross-ownership rule of subsection (b), a rule restricting cross-ownership between broadcast stations and local cable systems (subsection (a)(1)) and a provision granting authority to the FCC to adopt additional restrictions on ownership of cable systems by owners of other media of mass communications (subsections (c), (d)). The Commission has long had a regulation barring ownership of cable systems by a television network. 47 C.F.R. § 76.501(b). In 1992, Congress added a bar on ownership of a cable business by an in-region "multichannel multipoint distribution service" (MMDS, a form of "wireless cable") or a separate "satellite master antenna television service" (SMATV). Subsection (a)(2).

(1984).[13] *See also* 130 Cong. Rec. 27975 (1984) (statement of sponsor, Rep. Wirth) (cross-ownership rule intended "to promote a greater diversity of ownership of cable systems"). The bill as passed by the Committee did not contain a general waiver provision going beyond the "rural" exemption that is now found in paragraph (3). H.R. Rep. 934, *supra*, at 104. On the floor, however, the House added what is now paragraph (4), providing for "good cause" waiver authority. The debate over the flexibility to be accorded the Commission resolved itself by the express adoption of the Commission's pre-existing "good cause" language, the inclusion of language directing that waivers be granted "upon a finding that the issuance of such waiver is justified by the particular circumstances demonstrated by the petitioner, taking into account the policy of this subsection [*i.e.*, Section 533(b)]," and the floor declarations by the sponsors that the provision should be "narrowly construed." *See* 130 Cong. Rec. 27978, 31873, 32280 (1984).[14]

The legislative record makes clear that Section 533(b) was enacted without opposition from the local telephone companies. Those companies and their congressional supporters were not absent from the debate: expressly recog-

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[13] In discussing First Amendment issues, the House Report relies on this Court's decision in *FCC v. National Citizens Committee for Broadcasting (NCCB)*, 436 U.S. 775 (1978), unanimously upholding the broadcast-newspaper cross-ownership rule and, in addition, compares the telephone-cable cross-ownership "structural regulation" to the Bell breakup decree's bar on the local telephone monopolists' entry into related businesses. H.R. Rep. 934, *supra*, at 33, 57. The Senate Report refers to the 1981 FCC Staff report. S. Rep. 67, *supra*, at 20.

[14] The House version of the provision subsequently was adopted in conference and by both houses. *Id.* at 31884, 32277-88 (1984). At the same time, the conference added and both houses adopted what is now paragraph (6) of the statement of congressional purpose behind the 1984 Act: to "promote competition in cable communications and minimize unnecessary regulation that would impose an undue economic burden on cable systems." 47 U.S.C. § 521(6). The bill became law on October 30, 1984.

nizing cable's competitive threat to aspects of the telephone business, they fought hard to prevent cable operators from using the new Act to offer non-video services on their networks in direct competition with telephone services.[15] But they did not oppose the cross-ownership rule. To the contrary, the record states that, with the revisions worked out in the House (including the adoption of the "good cause" waiver authority), Bell Atlantic and other telephone companies gave explicit support for Section 533(b). 130 Cong. Rec. 27982 (1984) (remarks of Rep. Dingell)[16]; *see also Options for Cable Legislation, supra*, at 1088-89 (Pacific Telephone official noting absence of opposition to cross-ownership rule).

D. *Post-1984 Developments.* Consideration of the issue continued in the Commission after enactment of the statute. In 1988, the Commission tentatively concluded that it should recommend the statute's repeal. *Further Notice of Inquiry, In re Telephone Company-Cable Television Cross-Ownership Rules*, 3 F.C.C.R. 5849. The Commission recognized that commenters "have failed to present any evidence, and do not seriously contend, that carriers do not have the ability to subsidize affiliated cable operations" (*id.* at 5854) and noted that "telephone companies continue to have the ability to deny potential competitors access or to engage in anticompeti-

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[15] *See, e.g.*, H.R. Rep. 934, *supra*, at 26-27; 129 Cong. Rec. 15455-56, 15458-59, 15465, 15468-69, 15474 (1983); *Options for Cable Legislation: Hearings on H.R. 4103 et al. before the Subcomm. on Telecomm., Consumer Protection, and Finance of the House Comm. on Energy and Commerce*, 98th Cong., 1st Sess. 173, 435, 501, 607, 1087 (1983).

[16] "The measure the House is considering today contains additional protections for telephone companies regarding cross-ownership and pole attachment rules. With these additions, all issues of concern to the telephone industry have been fully and fairly resolved. I am aware of no formal objection to this legislation at this time from the telephone industry. Indeed, I have received support for the telephone-related parts of this measure from additional segments of the telephone industry, including Ameritech, Bell South, and Bell Atlantic." *Ibid.*

tive cross subsidies" (*id.* at 5860). Nevertheless, the Commission "tentatively conclude[d] that the costs of the cross-ownership ban exceed the benefits" (*id.* at 5858). The Commission specifically concluded that Section 533(b) is valid under the First Amendment (*id.* at 5864), so that its legislative recommendation of repeal was a matter of policy judgment—a judgment opposed at the time by, among others, the National Telecommunications Information Administration (NTIA). *Id.* at 5856; *see* Ct. App. JA 8090.

In 1992, the Commission (by a 3-2 vote) formally recommended that Congress "amend the Cable Act to permit the local telephone companies to provide video programming directly to subscribers in their telephone service areas, subject to appropriate safeguards." *Second Report and Order* (*Video Dialtone Order*), 7 F.C.C.R. 5781, 5847. The Commission recognized the dangers of this course of action but concluded that, if safeguards were adopted, the risks would be "outweighed by the potential public interest benefits." *Id.* at 5848-49. Both NTIA and the Justice Department now voiced similar policy views. *See* Pet. App. 55a n.8.

Congress, meanwhile, was actively considering the issue. Proposals to repeal Section 533(b) and to substitute a variety of regulatory safeguards (such as limitations on a telephone company's use of more than 25% of its channel capacity, coupled with separate corporate operations and close FCC supervision) were introduced in Congress repeatedly between 1988 and 1992. During extensive hearings, evidence was submitted explaining the continued existence of anticompetitive dangers and the inadequacy of regulatory checks. *See* Pet. App. 55a-56a; Ct. App. J.A. Tabs 65-67, 102-03, 107-22.

In the 1992 Cable Act, Congress rejected the proposals for repeal. It instead chose other means to regulate the cable industry, including rate regulation, prohibition of exclusive franchising, and promotion of diverse ownership of new wireless cable technologies. *See* 47

U.S.C. §§ 533(a)(2), 541(a), 543. The Senate Report accompanying the 1992 Act reaffirms that Section 533(b) and the other cross-ownership rules still "enhance competition." S. Rep. 92, 102d Cong., 1st Sess. 46-47 (1991).

II. This Litigation

A. *District Court Proceedings.* In 1992, respondents Chesapeake and Potomac Telephone Company of Virginia and Bell Atlantic Video Services brought this suit in the United States District Court for the Eastern District of Virginia seeking to enjoin enforcement of Section 533(b) as invalid under the First Amendment. The original defendants were the United States, the Attorney General, and the Commission. Petitioner NCTA intervened as a defendant. Ultimately (after judgment), Bell Atlantic Corporation and its other subsidiaries offering local telephone service (all respondents here) were joined as plaintiffs—collectively, "Bell Atlantic." *See* JA 4.

The parties filed cross-motions for summary judgment and compiled a record that, on the defendants' side, included expert economist affidavits, government reports, and other materials explaining the rationale behind Section 533(b) and the reasonableness of choosing a structural over a regulatory solution to the problems addressed by the statute. *See, e.g.*, JA 31 (1981 FCC Staff report), 79 (1987 GAO report), 119 (1993 GAO report), 222 (affidavit of professor and former Commissioner Glen Robinson), 241 (affidavit of Dr. Bruce Owen, professor and former chief economist of the Antitrust Division and of the White House Office of Telecommunications Policy), 331 (reply affidavit of Dr. Bruce Owen). The district court granted judgment for Bell Atlantic, holding that the statute on its face violates the First Amendment. Pet. App. 46a-93a. The court did not discuss, and the parties did not press any argument based on, the "good cause" waiver provision of Section 533(b)(4). *See* Pet.

App. 47a (treating case as involving only the presumptive bar set forth in Section 533(b)(1) and (2)).

The district court initially reasoned that the appropriate standard of review was neither strict scrutiny nor rationality review but "intermediate scrutiny" as set forth in *United States v. O'Brien*, 391 U.S. 367 (1968), and *Ward v. Rock Against Racism*, 491 U.S. 781, 791 (1989). The district court thus asked if the statute is " 'narrowly tailored to serve a significant governmental interest' " unrelated to content and " 'leave[s] open ample alternative channels for communication.' " Pet. App. 61a. On the second issue, the court had "little doubt that the statute leaves open ample alternative channels for communication." Pet. App. 81a. "Clearly, . . . § 533(b) operates only as a restriction on the 'manner' in which plaintiffs may speak, not as an outright ban on their ability to do so." Pet. App. 71a n.19.[17]

On the narrow tailoring issue, the district court readily concluded that "the preservation of diversity of ownership of communications outlets is a significant governmental interest" (Pet. App. 83a-84a), explained that "courts must not substitute their judgment on policy matters for that of Congress" (*id.* at 86a), and accepted that "cross-subsidization is uncontrollable by means of regulatory oversight" (*id.* at 91a & n.34). Nevertheless, the court

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[17] The court detailed some (though not all) of the ways Bell Atlantic may offer video speech. "Plaintiffs may provide video programming to audiences outside their service area, and may speak through any type of non-video medium to audiences inside their service area. Even more significantly, however, plaintiffs may also reach audiences within their service area with video programming. Section 533(b) only prohibits plaintiffs from *directly* providing video programming to their subscribers. Plaintiffs are not prohibited from producing their own video programming and marketing it to broadcasters or cable operators for transmission by means other than the plaintiffs' own facilities. Public access requirements ensure that such programming cannot be silenced by the entities responsible for the direct provision of video programming." Pet. App. 71a n.19.

held that the cross-ownership rule failed intermediate scrutiny for the sole reason that, in the court's view, there was no greater likelihood of exploitation of monopoly power from telephone companies' entry into cable than from what is currently permitted—offering of common-carrier video *transmission* service to unaffilated programmers, who then independently sell programming to consumers. *Id.* at 91a-92a ("[t]he essential point is that telephone companies may already, under existing law, compete in the video transport market, and if it were possible for them to reap supracompetitive profits in that market through cross-subsidization, the telephone companies could do so irrespective of § 533(b)"); *id.* at 88a. The district court enjoined enforcement of Section 533(b) against Bell Atlantic and its various subsidiaries. *See* Pet. App. 5a.

B. *The Court of Appeals Decision.* The Fourth Circuit affirmed. Pet. App. 1a-45a. The court began by stating that it need not consider the waiver provision of Section 533(b)(4), which the court described—overlooking the "good cause" standard—as limited to situations where cable service could not be provided except by a telephone company. Pet. App. 4a n.1. Looking only at Section 533(b)(1) and (2), the court agreed with the district court that the proper standard of review was "intermediate scrutiny," as most recently elaborated in *Turner Broadcasting System v. FCC*, 114 S. Ct. 2445 (1994). Pet. App. 16a-33a. In applying the standard, the court treated as wholly irrelevant this Court's unanimous ruling in *FCC v. National Citizens Committee for Broadcasting (NCCB)*, 436 U.S. 775 (1978), that a broadcast licensee could constitutionally be barred from entering the newspaper business in its broadcast service area. Pet. App. 18a-19a.[18]

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[18] The court mistakenly attributed to NCTA the view that *NCCB* calls for, and Section 533(b) should be subject to, mere rationality review. *See* Pet. App. 17a-20a. NCTA in fact urged that *NCCB*, though not expressly invoking any standard, supplied

Applying *Turner*, the Fourth Circuit agreed that the governmental interests in preventing "cross-subsidization" and "network-access discrimination" and "preserving diversity of ownership of communications outlets and of the means of electronic access to homes and businesses" were unquestionably significant. *Id.* at 33a-34a. The court also took as a given "that ordinary regulatory oversight is insufficient to guard against telephone company use of cross-subsidization in the cable transport market" and that, *contrary* to the district court's "essential" rationale, telephone company entry into the (less regulated) retail cable business does in fact present greater economic problems than telephone company offering of (more tightly regulated) common carrier transmission service. *Id.* at 39a. Even so, the court of appeals concluded that the statute failed intermediate scrutiny.

The first problem, the court held, was that in the absence of factual findings by Congress (Pet. App. 35a, 39a) or a record of pre-1984 FCC consideration of "other, less drastic regulatory schemes" (*id.* at 40a), the court was "not convinced" that Section 533(b) is narrowly tailored to address the identified problems. *Id.* at 39a. The court cited a single " 'obvious less-burdensome alternative' " as the reason for its conclusion (*id.* at 41a): a rule requiring telephone companies to offer a fixed percentage of their channel capacity to independent programmers (coupled, presumably, with rules on cost accounting and discrimination, plus administrative oversight). *Ibid.* The court did not offer an explanation, or citation to any evidence in the record, showing how—on the court's own assumption that "ordinary regulatory oversight is insufficient" (*id.* at 39a)—this alternative so demonstrably protected against the evils targeted by Section 533(b) as to justify upsetting Congress's judgment.

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a "similar framework" to intermediate scrutiny. NCTA Ct. App. Reply Br. 1, 8; *see* NCTA Ct. App. Br. 13, 16.

The second problem with Section 533(b), the court concluded, is that it does not "leave open ample alternative methods of communication." Pet. App. 43a. Without any reference to the "good cause" provision of Section 533(b)(4), the court characterized the statute as "bar[ring] absolutely the telephone companies from entering, with editorial discretion, the cable television market." *Id.* at 43a. The court did not dispute (or in some instances recognize) that Bell Atlantic may offer video programming in various ways: *e.g.*, through its own broadcast stations or networks or others' broadcast stations or networks; through its own satellite or wireless cable service; through independent cable systems (by selling its programming, as other cable programmers must do; or by using leased access, under 47 U.S.C. § 532); through providing its programming to the retail program packagers/providers on Bell Atlantic's own video network.[19] The court stressed that, "unlike other video programmers, the telephone companies *cannot guarantee* that their programming will reach this audience." Pet. App. 13a-14a.

Both the government and NCTA sought rehearing. Petitioner NCTA argued that the "good cause" waiver authority of Section 533(b)(4) was broad enough to allow for the very sort of "narrow tailoring" of restrictions on telephone company provision of video program-

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[19] On a video dialtone network with Section 533(b)(1) and (2) enforced, the telephone company provides the transmission platform (and several other consumer services) but does not act as a retail seller of programming to consumers. Instead, it leases channels on the network, individually or in groups, to independent programmers/packagers, who, like cable operators, may acquire programming from diverse sources and then act as the retailers of video programming to consumers. The Commission has made clear that Section 533(b) presents no bar to the telephone companies' reaching their in-region audience by supplying their programming to the independent programmers/packagers on their video dialtone networks. *See Video Dialtone Reconsideration Order*, 10 F.C.C.R. 244, 280-01 (1994); *In re Time Warner Entertainment Co.*, 8 F.C.C.R. 7106 (1993).

ming that would avoid the substantial constitutional problems that the Fourth Circuit found present in the basic cross-ownership bar (paragraphs (1) and (2)) when read in isolation from the waiver authority.[20] The government, however, was silent on the issue. The court of appeals denied rehearing on January 18, 1995. Pet. App. 94a-97a.

III. Subsequent Agency Action

Two days after rehearing was denied, the Commission released an order tentatively proposing the "saving" construction of the "good cause" waiver provision that the Fourth Circuit had just passed over without comment. *See* Pet App. 98a-102a. The Commission noted the substantial constitutional questions reflected in the Fourth Circuit's opinion and its obligation to construe the statute, which it administers, to avoid such questions. Pet. App. 100a.[21] The Commission explained that "good cause" ordinarily refers to "changed circumstances" and that circumstances in the cable industry—"no longer a fledgling industry"—had changed dramatically. *Id.* at 99a. The Commission also reasoned that, if regulatory safeguards designed to address the economic dangers underlying the statute were fashioned, compliance with those safeguards as a condition of a waiver would "constitute 'particular circumstances . . ., taking into account the policy' of Section 533(b)." Pet. App. 100a. In the Commission's proposed view, then, the "good cause" waiver provision, previously overlooked in the analysis of Section 533(b), should be construed to narrow the cross-ownership rule so

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[20] Prompted by a new Ninth Circuit ruling, *GTE California, Inc. v. FCC*, 39 F.3d 940, 946 (1994), NCTA had briefly raised this issue in a letter to the Fourth Circuit one week before the Fourth Circuit's decision.

[21] At present, all of the Regional Bell Operating Companies are beneficiaries of court decisions holding, without regard to the statutory waiver authority, that Section 533(b) is unconstitutional. *See* Pet. App. 109a n.15 (citing cases, including *US West, Inc. v. United States*, 48 F.3d 1092 (9th Cir. 1995)).

as to "render Section 533(b) constitutional." *Id.* at 101a.

On May 16, 1995, the Commission adopted this construction of Section 533(b)(4) as a final interpretive rule and concluded that Section 533(b)(4) authorized, at a minimum, the direct provision of programming by telephone companies over their video dialtone networks (*i.e.*, on networks open to independent programmers). *See* Pet. App. 103a, 104a. The Commission noted its duty to "avoid[] the constitutional infirmity identified by the Fourth and Ninth Circuits by making available the ' "obvious less-burdensome alternative" ' referenced by those courts." Pet. App. 107a; *id.* at 116a, 119a-20a. The Commission stated that "absent a waiver allowing telephone companies to offer video programming over video dialtone networks [that is, where other programmers have access to the video network], there is a serious question as to whether Section [533(b)] unnecessarily burdens substantially more speech than is necessary to promote competition in the multi-channel video programming market." *Ibid.* (footnote omitted).

The Commission explained that the policy behind Section 533(b) and the predecessor FCC rule is to promote competition, with the measures having sought to "prevent the telephone companies from using their monopoly position to preempt the market for cable service by excluding others from entry." Pet. App. 111a (footnote omitted). Given cable's maturity now, the Commission reasoned, the "concern with ensuring that the cable industry not be extinguished before it is established is no longer relevant." *Id.* at 112a. So, too, technological changes have "made it possible for a multitude of programmers to reach end user customers and have mitigated to a fair degree the competitive concerns" underlying the presumptive bar: these "changed circumstances" constitute "good cause" for a waiver under proper conditions. *Id.* at 112a-13a.

The Commission added that the rules establishing those conditions—including at least the provision by a tele-

phone company of programming on its own video dialtone network—will constitute " 'particular circumstances . . ., taking into account the policy' " of the statute. Pet. App. 113a (quoting § 533(b)(4)). These rules will not allow telephone company entry in any and all circumstances, but will impose limitations, and those limitations will be designed to address discrimination and cross-subsidization, the evils targeted by Section 533(b). Pet. App. 113a-114a, 117a. The circumstances thus will be "particular" and the policies of the statute taken into account. At the same time, the constitutional questions raised by the Fourth Circuit are avoided, as the waiver authority "constitutes implementation of the 'obvious less burdensome alternative' to the ban identified by the Fourth Circuit." Pet. App. 115a (footnote omitted).

SUMMARY OF ARGUMENT

The Fourth Circuit's invalidation of Section 533(b) should be reversed. The court properly gave the statute the searching inquiry into its justifications and reach that is required under intermediate scrutiny. Under those standards, however, the statute should be upheld, not struck down, against Bell Atlantic's challenge.

1. The Fourth Circuit's decision is wrong, first of all, because it violates the cardinal principle that a statute should be construed, where fairly possible, to avoid constitutional difficulties. The Fourth Circuit simply misread the waiver authority of Section 533(b)(4), disregarding the fact that the Commission is authorized to waive the presumptive cross-ownership bar for "good cause." That authority can hardly be ignored in judging the constitutionality of Section 533(b), for it plainly limits the restrictive reach of the statute. And the provision is in fact properly construed, as the Commission has now done, to narrow the impact of the presumptive cross-ownership bar on telephone companies' speech so as to avoid the serious constitutional questions identified by the Fourth Circuit and, indeed, expressly to allow Bell Atlantic to

offer video programming under the very type of narrowly tailored regulatory safeguards that the Fourth Circuit deemed the constitutionally required alternative to Section 533(b).

The Commission's construction of Section 533(b)(4) is based on identified changes in the circumstances directly relevant to the fulfillment of the pro-competitive policy of the statute. The Commission has thus specified "particular circumstances" in which there is "good cause" for waivers, "taking into account the policy" of the statute. Section 533(b)(4). The Commission's construction should be adopted because it "avoid[s] substantial constitutional questions" and is both "fairly possible" as a textual matter and "not plainly contrary to the intent of Congress." *United States v. X-Citement Video, Inc.*, 115 S. Ct. 464, 467, 472 (1994).

2. Even if this Court rejects the Commission's "saving" construction of Section 533(b)(4), it should reverse the court of appeals' facial invalidation of the statute on summary judgment. The Fourth Circuit did not question the reality of the economic problems targeted by Section 533(b). It rested its decision, instead, on its determination that the targeted problems could and should be addressed through regulatory standard-setting and oversight rather than a structural bar. But that conclusion was improper for the simple reason that there is no adequate ground for deeming unreasonable the congressional determination that regulatory measures are less than satisfactorily effective. Under the standards of intermediate scrutiny as set out in *Turner Broadcasting System v. FCC*, 114 S. Ct. 2445 (1994), Section 533(b) should survive.

The Fourth Circuit also faulted Section 533(b) for leaving too few avenues of speech open to local telephone companies. Nothing in *Turner*, however, indicates that there is a separate inquiry into other avenues of speech, once the statute has been shown to be narrowly tailored—that is, that the means adopted are more effective than alternatives at achieving an important government inter-

est. In any event, the Fourth Circuit's view of the speech avenues left open to local telephone companies was flawed factually and legally. In particular, the court gave little or no regard to a range of means by which telephone companies can offer in-region video speech, including broadcasting, wireless cable, and programming through the retail providers on the telephone companies' planned video dialtone networks. And the court improperly disregarded the most relevant precedent, this Court's decision in *FCC v. NCCB*, 436 U.S. 775 (1978), which unanimously held that the government, upon a proper justification in terms of a legitimate public interest, could bar a broadcaster from entering the newspaper business in its broadcast region, leaving the broadcaster free to publish an out-of-region newspaper and to engage in in-region non-newspaper speech. The similar cross-ownership rule here, well-justified in terms of important public interests, should likewise be upheld.

ARGUMENT

I. SECTION 533(b) IS VALID UNDER A PROPER "SAVING" CONSTRUCTION OF THE WAIVER AUTHORITY SET FORTH IN THAT SECTION

This Court has repeatedly stressed that "a statute is to be construed where fairly possible so as to avoid substantial constitutional questions." *United States v. X-Citement Video, Inc.*, 115 S. Ct. 464, 467 (1994). *See id.* at 472 (where a statutory construction "would raise serious constitutional doubts[,] [i]t is . . . incumbent upon us to read the statute to eliminate those doubts so long as such a reading is not plainly contrary to the intent of Congress").[22] This principle is rooted in the constitu-

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[22] *See, e.g., Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988); *NLRB v. Catholic Bishop of Chicago*, 440 U.S. 490, 499-501 (1979); *International Ass'n of Machinists v. Street*, 367 U.S. 740, 749-50 (1961); *Crowell v. Benson*, 285 U.S. 22, 62 (1932); *Murray v. The Schooner Charming Betsy*, 6 U.S. (2 Cranch) 64, 118 (1804).

tional respect owed to Congress by the Judicial Branch. It therefore imposes an independent duty on the courts—applicable even in a case, like the present, where the parties themselves overlooked the issue of a saving construction until well into the proceeding. *Cf. Jean v. Nelson*, 472 U.S. 846, 854-55 (1985) (applying rule although both sides, including Government, continued to press for constitutional ruling); *X-Citement Video*, *supra* (applying rule where Government urged saving construction for the first time in Supreme Court).

The principle applies in this case. The waiver authority set forth in Section 533(b)(4), if construed as the Commission has now properly construed it, eliminates the "substantial constitutional questions" identified by the Fourth Circuit and numerous other federal courts. Once such "questions" (or even "doubts") are acknowledged to be "substantial" or "serious," the waiver authority should be construed to narrow the statute, precisely in order to avoid actual decision of the constitutional issues.

A. The Commission's Construction of Section 533(b)(4) Removes the Bases for the Fourth Circuit's Invalidation of the Statute

The Fourth Circuit raised serious constitutional questions about Section 533(b)(1) and (2) not because it found the risks of monopoly abuse underlying the statute to be anything but real, but because it found that a flat cross-ownership bar is too ill-fitting a way of addressing those risks: the targeted problems can be addressed through regulatory standards, and too much speech is foreclosed by forbidding in-region cable service. In particular, as to narrow tailoring, the Fourth Circuit relied on the " 'obvious less-burdensome alternative' " of allowing a telephone company to provide programming on its network under rules requiring substantial access to that network for independent programmers. Pet. App. 41a. As to alternative avenues of communication, the Fourth Circuit found the critical flaw to be that "the telephone

companies *cannot guarantee* that their programming will reach [their in-region] audience." *Id.* at 13a-14a.

The Commission's interpretation of Section 533(b)(4) by its terms solves both of these problems. Pet. App. 107a, 116a, 119a-120a. While the Commission has not detailed *all* of the circumstances where telephone company provision of video programming would be allowed under Section 533(b)(4), it has explicitly concluded that such direct provision of video programming *is* authorized under the single set of conditions identified by the Fourth Circuit as presenting an " 'obvious less-burdensome alternative,' " *i.e.*, where the telephone company is one among many programmers on its video dialtone network. Pet. App. 104a, 106a. Similarly, allowing direct telephone company retailing of video programming under those conditions eliminates the reason the Fourth Circuit found the statute to leave open too few avenues of in-region speech: under the Commission's rule, the telephone companies *can* "*guarantee* that their programming will reach [their in-region] audience." *Id.* at 13a-14a. As the Commission concluded, its interpretation of Section 533(b)(4) directly eliminates the bases for the Fourth Circuit's facial invalidation of the statute.

Moreover, the Commission's interpretation solves any "as applied" problem here, because it allows Bell Atlantic to carry out its concrete plan for video programming. In the district court, Bell Atlantic alleged in its complaint and subsequently stipulated that, if permitted to proceed, its plan was to enhance its copper telephone network to allow for its own video programming and that "the network will also be available for use by other video programmers on a common carrier basis." JA 13 (Complaint ¶ 28, opening paragraph of "as applied" count). *See* JA 214 (Stipulation ¶ 97: "If C&P's telephone network is enhanced as referred to in the Complaint, ¶ 28, plaintiffs assertedly plan to . . . use the network, as enhanced, for the transmission to consumers of video programming provided by [Bell Atlantic's video affiliate]

[and] the video programming of unaffiliated program providers"); *ibid.* (Stipulation ¶ 98: Bell Atlantic's network would be available to "unaffiliated video programmers . . . on a tariffed, non-discriminatory, basis"). The Commission's interpretation of Section 533(b)(4) permits telephone company provision of video programming in just such circumstances.

B. The Commission's Interpretation of Section 533(b)(4) Is a Proper Saving Construction

The Commission's construction of Section 533(b)(4) is "fairly possible" as a textual matter. *X-Citement Video*, 115 S. Ct. at 467. The Commission, of course, is owed deference in construing Section 533(b)(4). *Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984). Under these standards, the "good cause" authority of Section 533(b)(4) may properly be read to permit a waiver upon compliance with regulatory safeguards that address the economic dangers underlying the general cross-ownership rule while reflecting any material changes of circumstances since adoption of the rule, *i.e.*, changes affecting the policy balance of risks and benefits addressed in the statute.

"Good cause," as the Commission observed, is commonly interpreted to refer to materially changed circumstances. Pet. App. 99a, 112a; *see, e.g., Illinois v. ICC*, 713 F.2d 305, 310 (7th Cir. 1983); *Greyhound Corp. v. ICC*, 668 F.2d 1354, 1362 (D.C. Cir. 1981).[23] In addi-

[23] Bell Atlantic has pointed to *Kleem v. INS*, 479 U.S. 1308 (1986) (Scalia, Circuit Justice), as taking a narrow view of "good cause." Bell Atlantic Response to Petitions at 20-21. But the invocation of good cause in that case involved no claim of changed circumstances. Moreover, unlike the asserted claim for good cause relief in *Kleem*, the Commission's interpretation of Section 533(b)(4) would not abolish the rule. The rule will apply to any telephone company that fails to meet the specific Commission requirements for a waiver and will, moreover, supply the policy that determines the contours of those waiver requirements—which might prove distinctly objectionable to some telephone companies.

tion, a waiver based on and confined to new and well-defined circumstances, if the changes alter the relevant policy balance, would be "justified by the particular circumstances demonstrated by the petitioner, taking into account the policy of this subsection." Section 533(b)(4). Indeed, the statute's express direction to the Commission to "tak[e] into account the policy" of the section is most naturally read as an affirmative textual indication of congressionally granted authority for the Commission to do just what it did here, *i.e.*, to assess whether any changed circumstances alter the policy balance behind the presumptive bar of paragraphs (1) and (2) of the statute so that relaxation of the bar in specified circumstances, rather than rigid enforcement of it, would serve the procompetitive policy behind Section 533(b) and the Cable Act as a whole. *See* 47 U.S.C. §521(6).[24]

The conclusion that this construction is "fairly possible" is consistent with this Court's holding in *MCI Telecommunications Corp. v. AT&T*, 114 S. Ct. 2223 (1994), that 47 U.S.C. § 203(b)(2), which permits the Commission to "modify" tariff-filing requirements only in "special circumstances," does not allow wholesale abrogation of the general tariff-filing rule. *Id.* at 2228. Most importantly, the principle requiring avoidance of serious constitutional issues played no role whatever in *MCI*. That principle significantly alters the interpretive calculus. Indeed, this Court in *X-Citement Video* relied on the principle to adopt what it acknowledged was not the "most natural grammatical reading" of the statute at issue. 115 S. Ct. at 467. *See also* cases cited in note 22, *supra*.

In any event, the statutory text at issue here is materially different from, and more readily accommodating of

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[24] Section 533(b)(4) also states that waivers are to be "made in accordance with" the FCC's cross-ownership *regulation* in effect on Sept. 20, 1984. 47 U.S.C. § 533(b)(4). That regulation, like the statute, identified "good cause" as an independent basis for a waiver.

the asserted "changed circumstances" authority than, the text of Section 203(b)(2). The *MCI* decision rested overwhelmingly on the restrictive meaning of Section 203(b)(2)'s word "modify" as allowing only "moderate change." *Id.* at 2229-32 (framing issue as turning on the meaning of "modify"). Section 533(b)(4) does not use that word, but instead uses the broader term "waive," which does not imply the same limited degree of change.[25] In addition, Section 533(b)(4) contains, whereas Section 203(b)(2) lacks, an explicit, affirmative directive to the Commission to grant relief based on a direct consideration of the underlying statutory policy; the inclusion of such a directive is naturally understood as a suggestion that the Commission do just what it did here. Also, whereas Section 203(b)(2) uses the phrase "*special* circumstances" to *restrict* the Commission's authority, Section 533(b)(4) uses a different phrase, "*particular* circumstances"—which more readily carries the meaning of detailed and specific, rather than peculiar or unusual—and it uses this phrase, moreover, *not* as a restriction on the relief the Commission "may" grant but, in a separate sentence, to set a standard for waivers the Commission "shall" grant.

Finally, the Commission's construction of the waiver standard does not effect an "abolition of the rule itself" (Bell Atlantic Response to Petitions at 21): far from freely allowing entry into cable, the Commission would impose specific conduct-based conditions implementing the policy of the specific statutory section—conditions to which, in fact, Bell Atlantic and other telephone companies may vigorously object. *See* Pet. App. 100a, 117a. For example, the Commission has indicated that it generally would deny waivers for telephone company entry into the cable

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[25] The dictionary definition of "waive" does not restrict the term to minor exceptions to a rule. *American Heritage Dictionary* 2008 (3d ed. 1992) ("give up (a claim or right) voluntarily; relinquish"; "refrain from insisting on or enforcing (a rule or penalty, for example); dispense with").

business through purchase of an existing cable system. *See* Pet. App. 117a. In its rulemaking to specify the conditions of waiver, the Commission may require telephone companies either to provide video dialtone service (allowing access by independent programmers) or to operate stand-alone cable systems, but not grant waivers for telephone companies to operate a joint voice-video facility over which it exercises control of the programming. The Commission may deny waivers for telephone companies that fail to comply with Title VI of the Communications Act, *i.e.*, with the Cable Act. The Commission may impose other requirements—*e.g.*, relating to corporate structure, accounting methods, audits, nondiscriminatory practices—as well. *See Fourth Further Notice of Proposed Rulemaking*, 10 F.C.C.R. 4617 (1995); 94-1893 Pet. App. 113a. Unlike the Commission decision in *MCI*, which simply eliminated the tariff-filing duty for a whole class of telephone companies defined by who they are (*i.e.*, nondominant), the Commission's construction of Section 533(b)(4) will leave the presumptive statutory bar in place for all telephone companies that, though they may wish otherwise, fail to act in accord with the behavioral requirements made conditions of waiver.

If the Commission's construction of the text is thus "fairly possible" within the meaning of the doctrine requiring avoidance of serious constitutional questions (*X-Citement Video*, 115 S. Ct. at 467; note 22, *supra*), the Commission's construction also is "not plainly contrary to the intent of Congress." *X-Citement Video*, 115 S. Ct. at 472. Whatever the precise reach of the congressional judgment made in 1984, nothing in the "sparse" legislative history (Pet. App. 53a) reveals a clear judgment to preclude Commission waiver if, in the district court's words, "the rapidly changing nature of the telecommunications field has caused the rationale supporting the [presumptive bar in the] statute to evolve over time." Pet. App. 81a. To the contrary, the language ultimately

adopted in paragraph (4) suggests a compromise, following debate on the flexibility of the authority to be left to the Commission, designed not to resolve the issue.[26]

The particular policies behind Section 533(b) support the same conclusion. Congress sought to promote competition in Section 533(b) based on its evident view that, in the circumstances then prevalent, the anticompetitive risks of telephone company entry into cable presumptively outweighed what ordinarily are the procompetitive benefits of allowing market entry. But like Bell Atlantic's expert, Professor Hazlett (JA 173-74), the Commission has now concluded that there have been several changes that materially alter that cost-benefit policy balance in particular circumstances: notably, on the risk-of-entry side, cable is no longer a "fledgling" industry whose very development is threatened by telephone entry; on the benefits-of-entry side, there are new imperatives for development of new technologies and potential benefits from fair competition in the video market. Pet. App. 99a-100a, 112a-113a; *Video Dialtone Order*, 7 F.C.C.R. at 5844-45, 5848-49.[27] There is no clear evidence that Congress foreclosed the Commission's ability to assess such changing conditions to determine whether, under defined circumstances, telephone entry would now serve rather than undermine the very policy that underlies the statute: "to prevent the development of local media monopolies and

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[26] The floor statement of the legislation's sponsors that the waiver authority should be "narrowly construed" (*see* page 14, *supra*), aside from being a familiar element of any such compromise, hardly forecloses the issue with any clear meaning: at most it prohibits the Commission from simply disagreeing with Congress's policy balance without any change of the circumstances that were considered by Congress. *See also Weinberger v. Rossi*, 456 U.S. 25, 35 n.15 (1982) (sponsors' remarks "are certainly not controlling").

[27] As discussed below (*see* pages 41-44, *infra*), this is a matter involving judgment calls on both factual and policy questions, as to which different views are both reasonable.

to encourage a diversity of ownership of communications outlets." H.R. Rep. 934, *supra*, at 55.

The Ninth Circuit adverted to the possibility of such a saving construction in *GTE California, Inc. v. FCC*, *supra*. *See* Pet. App. 99a, 121a. And contrary to Bell Atlantic's contention (Response to Petitions at 21-22), this construction of Section 533(b)(4) is in fact consistent with the actual ruling of the D.C. Circuit in *NCTA v. FCC*, 914 F.2d 285 (D.C. Cir. 1990)—which did not consider any constitutional issue (Pet. App. 120a) and could not, in any event, have influenced the intent of the 1984 Congress. The D.C. Circuit held that the "good cause" basis for waivers under Section 533(b)(4) focuses on whether "the advantages to be derived from [the telephone company's] application cannot be realized in the absence of a waiver" (*id.* at 289) but that the Commission had made no such showing in that case. Here, consistent with that standard, as well as with the Commission's evolving pre-1984 approach to waivers (*see* pages 7-8, *supra*), the Commission has identified advantages, including technological and competitive benefits, to be gained from telephone entry into the cable business under prescribed conditions. Pet. App. 100a, 112a-113a.

In sum, if changes in relevant circumstances so seriously loosen the fit between the cross-ownership bar and the risks it addresses as to raise a serious question about the measure's constitutionality, as the Fourth Circuit and Bell Atlantic have concluded, those same changes ought to constitute good cause for a waiver that avoids the constitutional concerns with Section 533(b). The Commission's interpretation of Section 533(b)(4) rests on such changes. It is a proper saving construction, and the Fourth Circuit's facial invalidation of Section 533(b) should be reversed on that ground.

II. EVEN WITHOUT REGARD TO THE WAIVER AUTHORITY, SECTION 533(b) SURVIVES INTERMEDIATE SCRUTINY

Even aside from its mistaken disregard for the narrowing function served by a proper construction of "good cause," the Fourth Circuit decision should be reversed. The "intermediate scrutiny" of *Turner* and its precursors, applied with a searching focus on the justifications for the law, is the proper standard for review. But the court of appeals drew improper conclusions at each of the two steps—narrow tailoring and alternative means of communication—where it found fault with Section 533(b)(1) and (2).[28]

A. The Statute Is Narrowly Tailored to Serve Important Government Interests Unrelated to the Suppression of Free Expression

This Court in *Turner* explained that a statute survives intermediate scrutiny if it both " 'furthers an important or substantial government interest . . . unrelated to the suppression of free expression' " (114 S. Ct. at 2469, quoting *O'Brien*, 391 U.S. at 377) and, in addition, satisfies the requirement of "narrow tailoring." *Ibid.* The Court summed up this requirement as demanding that the law not " 'burden substantially more speech than is necessary to further the government's legitimate interests.' " *Ibid.*, quoting *Ward v. Rock Against Racism*, 491 U.S. 781, 799 (1989). The Court also explained that the effectiveness of alternative means is part of the assessment: a

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[28] We hereafter assume, as the Fourth Circuit did, that the waiver authority provides no substantial narrowing of the statute. In other words, we assume that, contrary to our argument above, Congress reserved to itself, and did not grant the Commission, the authority to determine when circumstances could be found to have so changed that the policy of the statute could better be addressed through regulatory checks rather than a broad structural bar. In fact, as we have noted (pages 16-17, *supra*), Congress gave renewed consideration to the issues presented by the cross-ownership rule in 1991 and 1992, and it did not modify the statute.

law is narrowly tailored "'" so long as the . . . regulation promotes a substantial government interest that would be achieved less effectively absent the regulation."'" *Ibid.*, quoting *Ward*, 491 U.S. at 799, quoting *United States v. Albertini*, 472 U.S. 675, 689 (1985). The plurality in *Turner* then explained that, in the exercise of its "independent judgment when First Amendment rights are implicated," the Court's role is "to assure that, in formulating its judgments, Congress has drawn reasonable inferences based on substantial evidence." 114 S. Ct. at 2471.[29]

1. *The Interests Served by the Statute Are Important and Real*

The Fourth Circuit did not find, and could not have found, that Section 533(b) is facially invalid because it fails the first part of the intermediate-scrutiny test. That component of the test requires that the statute serve a real, rather than conjectural, interest unrelated to the suppression of free expression (here, the prevention of familiar economic harms) and that it directly and materially advance that interest (here, alleviate the harms). *Turner*, 114 S. Ct. at 2470 (plurality); *Edenfield v. Fane*, 113 S. Ct. 1792, 1798-99 (1993); *Rubin v. Coors Brewing Co.*, 115 S. Ct. 1585, 1592 (1995). The Fourth Circuit in this case correctly declined to fault Section 533(b) on this score.[30]

Both the background to Section 533(b) and the record in this case—to be judged under the standards applicable on summary judgment—attest to the well-recognized problems of economic abuse by a dual-market, regulated/unregulated monopolist that the statute addresses. The local telephone companies are still rate-regulated monop-

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[29] Applying that standard, the plurality in *Turner* was "unable to conclude that the Government has satisfied either inquiry" required by intermediate scrutiny. 114 S. Ct. at 2470.

[30] *Compare Turner*, 114 S. Ct. at 2470-71 (plurality) (serious question about the reality of the underlying alleged problem of a threat to the broadcast industry).

olies, and the cable business not only is less regulated but has long been clearly perceived by the telephone companies to constitute a serious, and growing, threat to their basic monopolies.[31] There are, moreover, unquestionably massive opportunities for cost-shifting and discrimination in the dual provision of telephone and cable service, at least in the situation contemplated by Bell Atlantic: the construction of a single network for the joint carriage of voice and video signals.[32]

In these circumstances, the local telephone companies have the classic incentives, and substantial opportunities, to use entry into the cable business—notably, through

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[31] *See* Pet. App. 67a; *United States v. Western Electric Co.*, 993 F.2d 1572, 1578 (D.C. Cir.), *cert. denied*, 114 S. Ct. 487 (1993); JA 254, 262, 270 (Owen affidavit), JA 201-02 (stipulations); JA 187 (Hazlett affidavit); JA 58-59 (FCC Staff study); *see also* pages 14-15, *supra* (legislative history reflecting telephone company recognition of cable threat to telephony at time of 1984 Act).

The Fourth Circuit did not dispute that telephone rate regulation, though modified in recent years to "mov[e] away" from the most traditional form of strict rate-of-return regulation (JA 299 (Bell Atlantic affiant)), still is widely tied to costs: nothing in the record suggests that "pure" price cap regulation, severing all connection to costs, has been adopted either by the FCC or generally by the States. (To sustain the Fourth Circuit's affirmance of the *facial* invalidation of Section 533(b), *see* Pet. App. 4a, 45a, 93a, Bell Atlantic would have to show—and it plainly has not—that "pure price cap" regulation has been so widely adopted by regulators as to render Section 533(b) "substantially overbroad." *Broadrick v. Oklahoma*, 413 U.S. 601, 615 (1973).) Indeed, the record evidence is to the contrary. JA 254 and 262-64 (Owen affidavit), JA 334 (Owen reply affidavit). Nor did the Fourth Circuit doubt that the telephone and cable markets present the structural conditions for the economic problem targeted by Congress: they have differential price regulation and demand elasticities. *See* JA 251, 253 (Owen affidavit). Telephone companies, upon entering the cable business, would not be subject to cable rate regulation under the 1992 Act. *See Cable Rate Regulation Order*, 8 F.C.C.R. 5631, 5648 (¶ 18 n.45) (1993).

[32] *See* JA 212-14 (stipulations that, among other things, enhancement of facilities in Alexandria, Virginia, alone will cost $50-100 million); JA 254 (Owen affidavit); JA 332 (Owen reply affidavit).

cost-shifting and discriminatory self-preference—to exploit telephone ratepayers, to harm the cable market, and to forestall the threat to the telephone monopoly that cable presents as the "second wire" for electronic communications. These problems, which are wholly unrelated to speech, are explained in detail in the record of this case (*see* JA 241-71 (Owen affidavit); JA 331-36 (Owen reply affidavit)), were elaborately set forth in the 1981 FCC Staff report (*see* pages 8-9, *supra*), were articulated by the United States at the time of the 1982 Bell System breakup (*see* pages 10-12, *supra*),[33] and have been recognized by the courts[34] and by the scholarly literature.[35]

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[33] The Justice Department's merger guidelines, which generally take a lenient view of when vertical integration is of antitrust concern, single out for special suspicion the case of vertical integration by a regulated monopolist. *See* JA 249; *United States Dep't of Justice Merger Guidelines* § 4.23 (June 14, 1984) ("Evasion of Rate Regulation").

[34] *See, e.g., Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973); *National Rural Telecom Ass'n v. FCC*, 988 F.2d 174, 178 (D.C. Cir. 1993) ("Firms can gain by shifting costs away from unregulated activities (where consumers would react to higher prices by reducing their purchases) into the regulated ones (where the price increase will cause little or no drop in sales because under regulation the prices are in a range where demand is relatively unresponsive to price changes)."); *California v. FCC*, 905 F.2d 1217, 1224 & n.5, 1235 (9th Cir. 1990) (discrimination problem, citing FCC sources; cost-shifting enables telephone company "to exact monopoly rents from basic service customers by burdening them with costs from unregulated activities"); *Southwestern Bell Corp. v. FCC*, 896 F.2d 1378, 1379 (D.C. Cir. 1990) ("Diversified telephone companies possess a natural incentive to shift costs to their regulated telephone service, and thereby guarantee the recovery of those costs from ratepayers.").

A similar point about the distinctive dangers of dual-market participation where one market is a regulated monopoly market has been recognized in the context of tie-ins. *See Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 36 n.4 (1984) (O'Connor, J., concurring in the judgment); *Fortner Enterprises, Inc. v. United States Steel Corp.*, 394 U.S. 495, 513 (1969) (White, J., dissenting).

[35] *See, e.g.*, JA 246-47; Brennan, *Why Regulated Firms Should Be Kept Out of Unregulated Markets: Understanding the Divesti-*

Beyond that, the history of telephone company actions against independent cable companies (prior to 1970 and afterward), and the history of comparable actions in related competitive markets that led to the Bell System breakup, show that the distinctive risks of the "regulated/unregulated" dual-market monopolist are anything but purely theoretical. *See, e.g.*, JA 253, 255-56 (Owen affidavit); pages 5-7, 10-12, *supra*. Section 533(b) directly prevents these evils.

The Fourth Circuit did not, and could not, deem any of this familiar economics an insubstantial basis for congressional action. In reaching its decision, moreover, the Fourth Circuit refused to adopt the district court's "essential point" (Pet. App. 91a-92a) and instead accepted that entry into the retail cable business presents greater dangers of the targeted abuses than does the telephone companies' participation, allowed today, in the tariffed, common carrier, regulated transmission business. Pet. App. 39a. Of course, recognition of those additional risks is the essential premise for the government's repeated insistence, in recommending repeal of Section 533(b) as a policy matter, that significant *new* regulatory safeguards are needed, over and above those applicable to the transmission service telephone companies can today offer, if the telephone companies enter the cable business. *See* JA 370-374 (1994 Administration White Paper detailing needed new safeguards); JA 377 (FCC Chairman); JA 382-85 (Assistant Secretary of Commerce). And the

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ture in U.S. v. AT&T, 32 Antitrust Bull. 741 (1987); M. Kellogg, P. Huber, & J. Thorne, *Federal Telecommunications Law* § 9.3.4 at 437 (1992) ("A regulated utility that is also involved in an unregulated competitive business may have both the incentive and opportunity to shift the costs of competitive operations onto the regulated side of the line."); *id.* § 3.2.4, at 144 ("Even if only partially successful, cross-subsidy may undermine competition or efficiency on both sides of the regulatory line. Prices of the regulated service may rise above cost while production of the unregulated good or service may shift into the hands of an inefficient provider.").

record on summary judgment supplies an explanation. Obtaining monopoly power over video transmission is quite simply more valuable to Bell Atlantic (which is therefore more likely to seek it) if it can be used to exploit the (less regulated) retail cable market than if its value is limited to the lesser profits available in the (more heavily regulated) transmission market. *See, e.g.*, JA 332-33 (Owen reply affidavit); *see National Rural Telecom Ass'n v. FCC*, 988 F.2d at 180-81. Not surprisingly, the Ninth Circuit, in its decision on Section 533(b), explicitly acknowledged the sufficiency of the evidence to establish this point. *US West, Inc. v. United States*, 48 F.3d 1092, 1102 (1995).

Section 533(b), in short, addresses—and directly and materially alleviates—well-recognized economic problems that are unrelated to speech. These problems have been expressly acknowledged by the Commission even as it has recommended repeal of Section 533(b) in the belief that the risks may be reduced (though not eliminated) by regulatory checks and are "outweighed" by the benefits of telephone entry into cable. *See* pages 15-16, *supra*. Nor are the problems limited in scope: they are "*inherent* in the joint provision of regulated monopoly services and unregulated competitive products or services" where substantial opportunities for cost-shifting and discrimination exist. *United States' Response to Public Comments*, 47 Fed. Reg. at 23,335 (emphasis added). The familiar problems addressed in the law were amply supported in law and telephone-company history and were not greatly controversial; indeed, the telephone companies themselves *accepted* the law. *See* page 15, *supra*. The Fourth Circuit properly did not question that Section 533(b) satisfies the first part of the *O'Brien* test.

2. *Congress Could Reasonably Find Alternatives to the Statute To Be Materially Less Effective Means of Addressing the Targeted Problems*

The basis for the Fourth Circuit's decision, instead, was its view about the proper means of addressing the

targeted evils. In the Fourth Circuit's view, Congress was required to rely on conduct-specific regulatory checks and administrative oversight, rather than a structural bar, as an adequate solution to the economic abuses addressed by the statute. Oddly enough, it reached this conclusion despite its explicit assumption that regulatory checks could reasonably be deemed insufficiently effective to prevent those abuses. Pet. App. 39a; *see also id.* at 91a & n.34 (district court likewise assuming regulatory inadequacy). The assumption, not the conclusion, was correct.

There is no reason in a case like this one to approach scrutiny of the judgment of insufficient regulatory effectiveness with a heavy dose of skepticism. *Compare Sable Communications of Cal., Inc. v. FCC*, 492 U.S. 115 (1989) (strict scrutiny of content-based law against the background of good reasons to suspect the lack of a dispassionate congressional assessment of regulatory effectiveness). Nor can this Court, in evaluating the constitutional validity of Congress's enactment, properly bind Congress to accept a regulatory agency's optimistic evaluation of its own capabilities (let alone other regulators' capabilities). In fact, there has long been ample support for the assessment that regulatory solutions are insufficiently effective to redress the problems of cost-shifting and discrimination endemic to a dual-market, regulated/unregulated monopolist.[36]

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[36] This is not to say that contrary assessments would be *un*reasonable, either on the factual question of how effective regulatory checks are likely to be or on the policy questions of how much inefficacy should be tolerated and how large are the offsetting benefits of telephone entry into cable. *See* pages 16-17, 23 & note 28, *supra* (new FCC assessments). As to the question of regulatory effectiveness, Professor Robinson has noted: "The gap between Congress and the FCC on how to deal with the telco problem reduces to a different assessment of the reliability of FCC regulations. The FCC believes that its own discretionary programs are sufficient to avoid the risks of anticompetitive conduct. Self-assessments are not inherently wrong, of course, but the bias on which they rest is always ground for others—Congress, the public

The 1981 FCC Staff report detailed the strong reasons to doubt the efficacy of attempts to set and enforce cost-accounting and non-discrimination standards. *See* page 9, *supra*. The United States, in explaining the Bell breakup, attested in even stronger terms to the same inadequacy, noting as well the persistent failure of the Commission to solve these problems despite considerable efforts. *See* pages 11-12, *supra*. The General Accounting Office has twice examined the possibility of realistic enforcement of cross-subsidy standards by the Commission and twice come to a negative conclusion. *See* JA 79 (1987 GAO report); JA 118 (1993 GAO report). And experts in this case have submitted affidavits, based on long experience with the industry and the Commission, casting substantial doubt on the effectiveness of regulatory solutions. *See* JA 226-40 (Prof. Glen Robinson, former FCC Commissioner); JA 265-69 (Owen Affidavit).

These and other sources provide substantial grounds, in addition to the long history of failed administrative efforts, to deem insufficiently effective any realistic program of administrative oversight of cost-shifting and discrimination. As to cross-subsidy, the fundamental problem is the absence of non-arbitrary, objective standards for the allocation of shared costs or the decision to incur certain costs at all.[37] Beyond that are the problems of

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and the courts as appropriate—to take a skeptical hard look at the assessment. This counsel comes with particular force in light of the history of telco regulation, a history of FCC frustration in controlling telephone company practices." JA 226.

[37] *See, e.g.*, JA 57 (1981 FCC Staff study), 84 (GAO report: "unavoidably subjective nature of the cost allocation process"), 267-68 (Owen affidavit); *Permian Basin Area Rate Cases*, 390 U.S. 747, 804 (1968) ("There is ample support for the Commission's judgment that the apportionment of actual costs between two jointly produced commodities, only one of which is regulated by the Commission, is intrinsically unreliable"; footnote quoting economist's statement that "'[t]o make laborious computations purporting to divide [such] costs is "nonsense on stilts"'"); *United States Dep't of Justice Merger Guidelines* § 4.23 n.35 (referring

the massive number of the relevant transactions, the complex technology involved, the gross disparity in information available to the telephone companies and regulators, and the substantial degree of discretion inevitably embodied in any accounting system, providing fodder for lengthy and costly disputes. *See*, *e.g.*, JA 231-35, 266; pages 9, 11, *supra*. Efforts to prevent subtle discriminatory self-preference in the provision of essential monopoly services are subject to similar problems of technological complexity, informational disparity, and room for costly debate. *See*, *e.g.*, JA 73-75, 231, 268-69; pages 9, 11, *supra*. And both of these sets of problems are magnified by the fact that telephone costs are divided and subject to regulation partly at the federal level and partly at the state level, so that regulatory oversight would have to be effective at both the state and the federal levels—at both which there are grave problems of inadequate resources. *See*, *e.g.*, JA 236-38, JA 79, JA 119.

In the end, as Bell Atlantic and the Bell Operating Companies explained to the D.C. Circuit, the choice between barring their entry into an adjacent unregulated business or allowing entry subject to regulatory oversight "involves multi-faceted *policy judgments* based on market analysis, administrative experience, enforcement priorities,

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to "insoluble cost allocation problem"); *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 27 (1st Cir. 1990), *cert. denied*, 499 U.S. 931 (1991) ("Accounting systems for allocating investment between different services or customer classes are notoriously complicated and sometimes arbitrary." (quoting sources); M. Kellogg, P. Huber, & J. Thorne, *supra*, § 3.2.4, at 144 ("Certainly, the allocation of costs between closely related and interdependent businesses is an essentially arbitrary exercise; many economists therefore take cross-subsidy concerns very seriously. Cross-subsidy is of greatest concern when there are important common or joint costs among regulated and unregulated businesses—costs that cannot be clearly attributed to one business or the other."); *id.* § 9.3.4, at 437 ("common costs do create enormous opportunities for accounting hanky-panky").

economic policy, and a complex balancing of competitive risks and benefits; these judgments are not simple findings of fact or even applications of law to fact." Brief of the Bell Company Appellees at 50, *United States v. Western Electric*, No. 91-5263 (D.C. Cir. Aug. 17, 1992). Just as there was no adequate basis for the courts to set aside the government's judgment call on that issue when it proposed to lift the consent-decree restriction on the telephone companies' provision of "information services" (*United States v. Western Electric*, 993 F.2d at 1576-82) (balance of policies primarily for government, and judicial role limited to assuring reasonableness of government view, even if opposing view is also reasonable)), so there is no adequate basis for the judiciary to set aside the congressional judgment on the issue here. The Fourth Circuit could not properly make its own independent, intuitive judgment about regulatory effectiveness and the other elements of the policy mix the basis for invalidating a congressional enactment.

B. The Statute Is Not Properly Condemned As Leaving Insufficient Alternative Avenues of Communication

If Section 533(b) is narrowly tailored to serve the unquestionably important, speech-neutral governmental interests behind it—that is, if other means would not be as effective at protecting those interests (*Turner*, 114 S. Ct. at 2469)—it is hard to see what independent weight would attach to the Fourth Circuit's view, were it correct, that Section 533(b) also has too great an impact on Bell Atlantic's opportunities for speech. This Court in *Turner*, in describing the requirements of intermediate scrutiny, did not suggest that a statute must meet some additional, independent requirement of the sort applied by the Fourth Circuit. Rather, it ruled that a statute survives intermediate scrutiny, once it is shown to further an important government interest unrelated to the suppression of free expression, if it is narrowly tailored,

that is, if the interest would be achieved "'"less effectively absent the regulation"'" and hence the measure does not "'"burden substantially more speech than is necessary"'" to further the interest. 114 S. Ct. at 2469. Under that formulation, the constitutional inquiry would seem to be at an end based on the showing, made above, that Congress could reasonably find alternatives to the cross-ownership bar insufficiently effective at serving the important speech-independent interest in preventing the economic abuses targeted by the statute.

In any event, even if the "alternative avenues" inquiry represents a separate requirement of *O'Brien* scrutiny, the Fourth Circuit's view on this issue is factually and legally flawed. The court took too narrow a view of the opportunities that Bell Atlantic has to reach its desired (in-region) video customers under Section 533(b)(1) and (2). The court also took too narrow a view of the legal standards for judging the sufficiency of those opportunities.

As a factual matter, Bell Atlantic is hardly foreclosed from reaching in-region consumers with its video speech. Bell Atlantic may develop programming to offer to a local cable system or to a local broadcaster or satellite or other delivery service (or video store). Nothing in Section 533(b) bars Bell Atlantic from becoming a broadcaster itself (*see American Scholastic*, *supra* (statute applies only to "cable system")), or offering satellite service (direct broadcast service (DBS)), or offering "wireless cable" service (MMDS).[38] Bell Atlantic also may develop entire packages of programming and enter into contracts to supply the content for any of the programmer-retailers who will be dealing directly with sub-

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[38] Bell Atlantic has in fact recently taken a large stake in an MMDS operator. *See Bell Atlantic to Shift to 'Wireless Cable' TV*, Wash. Post, May 17, 1995, at F1; *RBOCS Pump $100 Million Into Wireless Cable Firm, Spurring Consolidation*, Communications Daily, Mar. 30, 1995, at 1.

scribers on the Bell Atlantic "video dialtone" network. *See* Bell Atlantic Ct. App. Br. 74 (anticipating "hundreds or thousands" of channels on network). *See also* 47 U.S.C. § 532 (leased access to cable systems).

Bell Atlantic accordingly is in a comparable position to that of cable programmers today who do not own or control their own cable systems. *Compare* Pet. App. 13a-14a. What Section 533(b)(1) and (2) precisely bar is the in-region retailing of *wire*-delivered video programming on a cable system, because that is the activity presenting the targeted problems of economic abuse. This bar, while triggering First Amendment scrutiny, does not leave the telephone companies without alternative means to reach in-region customers with their video programs.

In judging Section 533(b)(1) and (2) unduly limiting, the Fourth Circuit not only ignored several of the channels of communication just mentioned, but also disregarded what would seem the central precedent for judging the legal significance of the opportunities for speech left unrestricted to Bell Atlantic—*FCC v. NCCB*, *supra* —in which this Court unanimously upheld the bar on in-region broadcaster-newspaper cross-ownership. The Fourth Circuit simply dismissed the relevance of this Court's decision in *NCCB* on the ground that "the regulation there at issue affected ownership *of the broadcast media*" and "the instant case does not involve regulation of the broadcast media." Pet. App. 19a (emphasis in original; footnote omitted). These statements accurately describe a distinction, but they furnish no explanation of why the distinction matters under the First Amendment.

In *NCCB*, this Court, applying a standard comparable to intermediate scrutiny (though not invoking any specific standard), held that the government could constitutionally impose a flat ban that prohibited the holder of a broadcast license, as long as it retained that license, from entering the most venerable of protected speech businesses (newspaper publishing) in its service area.

The Court explained that the ban was justified as serving the goal of diversity of local media ownership. And the Court concluded that sufficient alternative avenues of communication were left to the broadcaster, who could engage in non-newspaper speech in-region plus all forms of speech out-of-region. *NCCB*, 436 U.S. at 794-802.[39]

If *NCCB* is a "broadcaster" case, the First Amendment relevance of that fact must reside not in labels but in the fact that the government may legitimately deem common ownership of a broadcast station and a newspaper in the same community to give rise to a genuine public problem: undue power in local speech markets. So, here, the government may legitimately deem common ownership of a local telephone monopoly and a cable system to give rise to a genuine public problem. Indeed, the law addressing this problem should be of less, not more, First Amendment concern than the measure in *NCCB*. Here, after all, the foreclosed business is cable service, not newspaper publishing, and the government purpose rests on traditional, non-suspect, speech-neutral economic concerns, not simply a government assessment of the degree of power someone should have as a speaker.

NCCB thus supports the conclusion that, given the established dangers of monopoly abuse, a local telephone monopolist, as long as it remains a local telephone monopolist, may be barred from entering the cable business in-region—and unrestricted opportunities for out-of-region speech of all sorts, and for all speech but direct cable retailing in-region, are legally sufficient. If a company may be required to exit a *speech* business (broadcasting) as a condition of entering another protected speech business (newspaper publishing or cable), the First Amendment impact is smaller, not greater, when

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[39] Relying on *NCCB*, the Fifth Circuit has upheld the cable-broadcast cross-ownership rule against First Amendment challenge. *See Marsh Media Ltd. v. FCC*, 798 F.2d 772 (5th Cir. 1986), *cert. denied*, 479 U.S. 1085 (1987).

entry into a protected speech business is conditioned on foregoing participation in a *non-speech* business (telephone common carriage). *Cf. FCC v. League of Women Voters*, 468 U.S. 364, 387 (1984) (broadcasters have more, not less, speech rights than common carriers). The Fourth Circuit erred in disregarding *NCCB* in this case.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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UNITED STATES OF AMERICA, ET AL., PETITIONERS

v.

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA, ET AL.

NATIONAL CABLE TELEVISION ASSOCIATION, INC., PETITIONER

v.

BELL ATLANTIC CORPORATION, ET AL.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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QUESTION PRESENTED

Whether 47 U.S.C. 533(b), which bars local telephone companies from directly providing video programming to subscribers in their telephone service areas, violates the First Amendment.

PARTIES TO THE PROCEEDINGS

Petitioners in No. 94-1893, defendants-appellants below, are the United States, the Federal Communications Commission, and Janet Reno, in her official capacity as the Attorney General of the United States. Petitioner in No. 94-1900, an intervenor-defendant and also an appellant below, is the National Cable Television Association, Inc. Respondents, plaintiffs-appellees below, are The Chesapeake and Potomac Telephone Company of Virginia, Bell Atlantic Video Services Company, Bell Atlantic Corporation, Chesapeake and Potomac Telephone Company, C & P Telephone Company of Maryland, The Chesapeake and Potomac Telephone Company of West Virginia, The Diamond State Telephone Company, The Bell Telephone Company of Pennsylvania, and New Jersey Bell Telephone Company.

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In the Supreme Court of the United States

OCTOBER TERM, 1995

No. 94-1893

UNITED STATES OF AMERICA, ET AL., PETITIONERS

v.

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA, ET AL.

No. 94-1900

NATIONAL CABLE TELEVISION ASSOCIATION, INC., PETITIONER

v.

BELL ATLANTIC CORPORATION, ET AL.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE FEDERAL PETITIONERS

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-52a) is reported at 42 F.3d 181.[1] The opinion of the

[1] "Pet. App." refers to the appendix to the petition in No. 94-1893. "Pet. Supp. Br." refers to the supplemental brief in support of the petition in No. 94-1893. "Pet. Supp. App." refers to the appendix to that supplemental brief. "Resp." refers to the response to the petitions for a writ of certiorari. "J.A." refers to the joint appendix.

district court (Pet. App. 53a-108a) is reported at 830 F. Supp. 909. The Federal Communications Commission's Third Report and Order (Pet. Supp. App. 1a-21a), concerning the statutory provision for waivers of the cross-ownership bar, is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on November 21, 1994. Petitions for rehearing were denied on January 18, 1995. Pet. App. 109a-112a. On March 24, 1995, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including May 18, 1995. The petitions for a writ of certiorari were filed on May 18, 1995, and were granted on June 26, 1995. J.A. 387, 388. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The First Amendment to the United States Constitution provides that "Congress shall make no law * * * abridging the freedom of speech, or of the press." The text of 47 U.S.C. 533(b) is set forth at Pet. App. 167a-168a.

STATEMENT

1. This case involves a First Amendment challenge to 47 U.S.C. 533(b), a regulation of the market for cable television services that bars local telephone companies (local exchange carriers or LECs) from directly providing video programming, by means of a cable system, to subscribers in their telephone service areas. Section 533(b) was enacted as part of Congress's comprehensive regulation of the cable industry in the Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2779 (Cable Act or 1984 Cable Act); see § 2, 98 Stat. 2785. It is similar to another cross-ownership rule, enacted at the same time, that prohibits local television broadcast stations from owning cable systems in their

service areas. See 47 U.S.C. 533(a)(1) (1988 & Supp. V 1993). It also stands in a long line of congressional and administrative initiatives to promote diversity in media outlets.[2]

Section 533(b) addresses the special potential for anti-competitive conduct by LECs, which are generally regulated monopolists within their common carrier telephone service areas, in less regulated markets such as the market for cable services. LECs' telephone operations are, in general, subject at the state level to rate regulation based on a return on capital and recovery of costs. If LECs entered the cable market, they would have an incentive to allocate the costs of their cable services to their monopoly telephone operations, and to have regulators set higher telephone rates based on those shifted costs. Such cost-shifting would allow LECs to impose their cable costs on captive telephone ratepayers without sacrificing telephone service market share, and to subsidize their affiliated cable entities with monopoly telephone profits. Telephone consumers would suffer higher rates based on distorted costs, and businesses competing with LECs' affiliated cable entities might wither under

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[2] See, *e.g.*, *FCC* v. *National Citizens Comm. for Broadcasting*, 436 U.S. 775 (1978) (upholding restrictions on cross-ownership of daily newspapers and broadcast stations); *National Broadcasting Co.* v. *United States*, 319 U.S. 190 (1943) (upholding regulation prohibiting network ownership of more than one broadcast station in a service area); *United States* v. *Paramount Pictures, Inc.*, 85 F. Supp. 881 (S.D.N.Y. 1949) (antitrust decree requiring separation of production and exhibition of motion pictures), aff'd mem. *sub nom. Loew's, Inc.* v. *United States*, 339 U.S. 974 (1950); 15 U.S.C. 1801-1804 (Newspaper Preservation Act); 47 U.S.C. 531 (municipalities may require public access to cable system); 47 U.S.C. 532 (1988 & Supp. V 1993) (cable systems must set aside channels for leased access); 47 U.S.C. 534(b), 535(b) (Supp. V 1993) (cable systems must carry local broadcast stations). See H.R. Rep. No. 934, 98th Cong., 2d Sess. 33 & n.3 (1984) (placing telephone-cable cross-ownership rule in line of authority holding that "the government can restrict concentrated ownership of communications media in a locality, in the interest of diversity").

unfair competition because of the subsidy from the telephone operations.[3]

The potential for such "cross-subsidization" by LECs is particularly serious in the cable market, which is adjacent to, and potentially overlapping with, the telephone market. Affiliated LECs and cable systems could share capital equipment, such as fiber-optic cable, as well as the costs of research and development, administration of the telephone network, and personnel. Also, because the technology has developed for the transmission of video signals over the telephone network, LECs could deliver video programming over their own wires. Thus, LECs would have substantial opportunities to cross-subsidize their cable operations if they were permitted to operate cable systems in their own service areas. A regulatory approach to the problem of cross-subsidization

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[3] See generally *National Rural Telecom Ass'n* v. *FCC*, 988 F.2d 174, 178 (D.C. Cir. 1993); *California* v. *FCC*, 905 F.2d 1217, 1224, 1226-1228, 1233-1238 (9th Cir. 1990); *United States* v. *Western Elec. Co.*, 900 F.2d 283, 289-290 (D.C. Cir.), cert. denied, 498 U.S. 911 (1990); *Southwestern Bell Corp.* v. *FCC*, 896 F.2d 1378, 1379-1380 (D.C. Cir. 1990); *Illinois Bell Tel. Co.* v. *FCC*, 740 F.2d 465, 472 (7th Cir. 1984); *United States* v. *American Tel. & Tel. Co.*, 524 F. Supp. 1336, 1368-1369 (D.D.C. 1981); *In re Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Services by the Bell Operating Companies, Report and Order*, 95 F.C.C.2d 1117, 1129-1131 (1983) (*BOC Separation Order*); *In re Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), Final Decision*, 77 F.C.C.2d 384, 463-464 (1980) (*Computer II*), modified in part on reconsideration, 84 F.C.C.2d 50 (1980), 88 F.C.C.2d 512 (1981), aff'd *sub nom. Computer & Communications Indus. Ass'n* v. *FCC*, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983); General Accounting Office, *Telephone Communications: Controlling Cross-Subsidy Between Regulated and Competitive Services* 50 (Oct. 1987) (*First GAO Report*) (J.A. 92-93); General Accounting Office, *Telecommunications: FCC's Oversight Efforts to Control Cross-Subsidization* 3-4 (Feb. 1993) (J.A. 122-123); Harvey Averch & Leland L. Johnson, *Behavior of the Firm Under Regulatory Constraint*, 52 Am. Econ. Rev. 1052 (1962); 2 Alfred E. Kahn, *The Economics of Regulation* 54 (1988).

would require extensive supervision and auditing of LECs' use of their capital equipment, deployment of their human resources, and accounting practices.[4]

A second problem posed by entry of LECs into the cable market is the threat of discrimination against their competitors in the use of facilities for the transmission of video signals. That discrimination could take at least two forms. First, traditional cable systems transmit programming to subscribers over wires attached to utility poles or buried underground and brought into subscribers' homes through utility service conduits. LECs have had, historically, effective control over poles and conduits necessary to the operation of a cable system, and they could abuse that control to prevent competing cable operators from using those poles and conduits, or to make it difficult for competitors to maintain their wires as is necessary to ensure adequate quality.[5] Second, LECs wield exclusive control over the wires, switching devices, and other transmission facilities essential to the delivery of video signals over the technically complex modern telephone network. Absent effective regulation, LECs could discriminate against competing video programmers in affording access to that network, by designing the system to favor transmission of their own video signals and providing inferior service and maintenance to competitors using the network. Discrimination unchecked by regulation could cripple competition if LECs were to exceed their traditional role of common carriers of others' signals.[6]

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[4] See J.A. 52, 54-55, 57 (1981 FCC staff study), 251-255 (Owen affidavit); cf. J.A. 84-85, 88-92 (*First GAO Report*, discussing similar problems in LEC entry into other lines of business).

[5] See *In re Applications of Tel. Cos. for Section 214 Certificates for Channel Facilities Furnished to Affiliated Community Antenna Television Systems*, 21 F.C.C.2d 307, 324 (1970), aff'd *sub nom. General Tel. Co.* v. *United States*, 449 F.2d 846 (5th Cir. 1971).

[6] See *California* v. *FCC*, 39 F.3d 919, 929-930 (9th Cir. 1994); *California* v. *FCC*, 4 F.3d 1505, 1509-1513 (9th Cir. 1993); *United*

2. Section 533(b) has its origins in regulations issued by the Federal Communications Commission (FCC) in 1970 to address the problem of anti-competitive practices by LECs in the cable services market. See 47 C.F.R. 64.601 (1971); *In re Applications of Tel. Cos. for Section 214 Certificates for Channel Facilities Furnished to Affiliated Community Antenna Television Systems*, 21 F.C.C.2d 307 (1970), aff'd *sub nom. General Tel. Co.* v. *United States*, 449 F.2d 846 (5th Cir. 1971). The FCC identified "[t]he central problem" as "the anomalous competitive situation between [cable] systems affiliated with the telephone companies, and those which have no such affiliation" (21 F.C.C.2d at 323), and concluded that "[t]he entry by a telephone company * * * into the retailing aspects of [cable] services in the community within which it furnishes communications services can lead to undesirable consequences," including discrimination against unaffiliated cable companies and extension of LECs' telephone monopoly to the cable services market (*id.* at 324). Intending "to insure against any arbitrary blockage of th[e] gateway" and to preserve "a competitive environment for the development and use of broadband cable facilities and services and thereby avoid undue and unnecessary concentration of control over communications media either by existing carriers or other entities," the FCC determined that "the preservation of such competition will best be assured by the exclusion of telephone companies in their service areas from engaging in

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States v. *American Tel. & Tel. Co.*, 552 F. Supp. 131, 189-190 (D.D.C. 1982), aff'd mem. *sub nom. Maryland* v. *United States*, 460 U.S. 1001 (1983); *United States* v. *American Tel. & Tel. Co.*, 524 F. Supp. at 1352-1355; *BOC Separation Order*, 95 F.C.C.2d at 1134-1135; *Computer II*, 77 F.C.C.2d at 463-464. See also *Delaware, L. & W.R.R.* v. *United States*, 231 U.S. 363, 370 (1913) (upholding "commodities clause" of Interstate Commerce Act, 49 U.S.C. 10746, which prohibits common carriers from transporting products in which they have a financial interest, and noting potential for discrimination if common carriers were permitted to haul for their own benefit as well as others').

the sale of [cable] service to the viewing public except where no practical alternative exists to make such service available within a particular community." *Id.* at 325.

In 1980, the FCC directed its staff to study several regulatory restrictions on ownership of cable systems, and in November 1981, the Commission's Office of Plans and Policy issued a report recommending that the telephone-cable cross-ownership bar be retained. See *FCC Policy on Cable Ownership: A Staff Report* 141-178 (J.A. 40-78). The staff report acknowledged that changes in the cable industry made it "no longer appropriate to think of [cable] as an infant," J.A. 41 n.3, but it nonetheless concluded that there were serious disadvantages in cross-ownership, principally in that "telephone companies are regulated exclusive franchise monopolists in their local area," J.A. 52. The staff was especially concerned about cross-subsidization of cable operations by LECs, and it noted that, because cable and telephone systems may share capital equipment, "allocating shared costs between these capital accounts on the basis of actual cost causation will be difficult or impossible." J.A. 57. The staff did not believe that a structural separation of corporate entities providing cable and telephone services would eliminate the danger of cost-shifting. J.A. 67-71. The staff also could not find a regulatory solution to the problem of discrimination in access to the local exchange network. J.A. 73-76.

3. Congress enacted Section 533(b) in the 1984 Cable Act, using language borrowed from the FCC's 1970 regulations. Congress prohibited "any common carrier, subject in whole or in part to subchapter II" of the Communications Act of 1934 (*i.e.*, any LEC), from "provid[ing] video programming directly to subscribers in its telephone service area." 47 U.S.C. 533(b)(1). Congress also prohibited LECs from providing pole or conduit space to any affiliated cable entity for the purpose of providing video programming directly to subscribers. Congress intended "to codify [the] FCC rules concerning the

provision of video programming over cable systems by common carriers." H.R. Rep. No. 934, 98th Cong., 2d Sess. 56 (1984) (*1984 House Report*). Section 533 as a whole was intended "to prevent the development of local media monopolies, and to encourage a diversity of ownership of communications outlets." *Id.* at 55.

The statute contains several exceptions to the general prohibitions, also derived from the FCC's regulatory regime. Under Section 533(b)(3), LECs may freely provide video programming to customers who reside in a "rural area," as defined by the FCC. LECs may also seek a waiver of the cross-ownership bar for those areas where cable service "demonstrably could not exist" except if provided through a LEC-affiliated entity. 47 U.S.C. 533(b)(4). Finally, Congress authorized the FCC to waive the cross-ownership bar "upon other showing of good cause * * * [and] upon a finding that the issuance of such waiver is justified by the particular circumstances demonstrated by the petitioner, taking into account the policy of this subsection." *Ibid.*

4. Within a few years of the enactment of Section 533(b), LECs and others began to urge its repeal.[7] Beginning in 1987, the FCC conducted extensive public inquiry and rulemaking proceedings regarding the costs, benefits, and continued need for the cross-ownership bar.[8]

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[7] See, *e.g.*, *Communications Competitiveness and Infrastructure Modernization Act of 1990: Hearing Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science, and Transportation*, 101st Cong., 2d Sess. 47-60, 143-158, 168-176 (1990); *Cable Television Regulation (Part 1): Hearings Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 101st Cong., 2d Sess. 273-276, 311, 339-342, 398-401, 431-436, 452-463 (1990).

[8] See *In re Tel. Co.—Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Notice of Inquiry*, 2 F.C.C. Rcd 5092 (1987); *In re Tel. Co.—Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Further Notice of Inquiry and Notice of Proposed Rulemaking*, 3 F.C.C. Rcd 5849 (1988) (*Further Notice of In-*

In 1992, the FCC again examined the bar in the context of its rulemaking proceedings on "video dialtone," a service made possible by technological advances that permit the transmission of video signals over telephone wires, by which LECs may use their wires to transmit video signals from multiple programmers to subscribers on a common carrier basis. See *In re Tel. Co.—Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking*, 7 F.C.C. Rcd 5781, 5783 (1992) (*Video Dialtone Order*), modified in part on reconsideration, 10 F.C.C. Rcd 244 (1994); see also *National Cable Television Ass'n* v. *FCC*, 33 F.3d 66 (D.C. Cir. 1994).

The FCC recommended that Congress replace the cross-ownership bar with an array of regulatory safeguards to prevent abuses by LECs if they entered the cable market. See *Video Dialtone Order*, 7 F.C.C. Rcd at 5847-5851. The FCC did not conclude that the potential for anti-competitive conduct by LECs had disappeared entirely, but it did conclude that the continued risk was outweighed by the potential public interest that would be served by their entry into the cable market. *Id.* at 5849. The FCC stated that, if LECs were allowed to enter the market for providing video programming, it would subject them to extensive regulation:

> [T]he FCC should require that if the benefits exceed the costs, the telephone companies provide video programming through a structurally separated video programming subsidiary; that their video programming be through the video dialtone platform that provides service to multiple programmers; and that the extent of local telephone company-provided

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quiry); *In re Tel. Co.—Cable Television Cross-Ownership Rules, Sections 63.54-63.58, First Notice of Proposed Rulemaking, First Report and Order, and Second Further Notice of Inquiry*, 7 F.C.C. Rcd 300 (1991).

programming be limited to a specified percentage of overall capacity.

Id. at 5847-5848; see *id.* at 5850-5851.

Congress, however, declined to repeal the cross-ownership bar. In the Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (1992 Cable Act), Congress revised regulation of the cable industry to stimulate competition. See 47 U.S.C. 541(a)(1) (Supp. V 1993) (prohibiting exclusive cable franchises); 47 U.S.C. 543 (Supp. V. 1993) (requiring cable rate regulation in areas where there is no effective competition); 47 U.S.C. 533(a)(2) (Supp. V 1993) (adopting cross-ownership rules for new wireless broadcast technologies). By those measures, Congress sought to promote "a substantial governmental and First Amendment interest in promoting a diversity of views." 1992 Cable Act, § 2(a)(6), 106 Stat. 1461. But after extensive consideration of the arguments in favor of and against the telephone-cable cross-ownership bar, and several proposals (including those of the FCC and the Departments of Justice and Commerce) to replace the bar with a regulatory approach to the problems of cross-subsidization and discrimination, Congress left the bar in place.[9] The Senate report accompanying the 1992 Cable Act expressed the view that cross-ownership restrictions like Section 533(b) "enhance competition."

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[9] See note 7, *supra*; see also *Cable Television Regulation: Hearings Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 102d Cong., 1st Sess. 122-123, 226-227, 524-537, 605-616 (1991); *Cable-Instructional TV and S. 1200, Communications Competitiveness and Infrastructure Modernization Act of 1991: Hearing Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science, and Transportation*, 102d Cong., 2d Sess. 48, 51, 54-55, 95, 96-109, 139-146 (1992); 138 Cong. Rec. S16,663, S16,665-S16,666 (daily ed. Oct. 5, 1992); *id.* at S14,225, S14,237, S14,246-S14,247, S14,250, S14,255-S14,256 (daily ed. Sept. 21, 1992); *id.* at H8671, H8673 (daily ed. Sept. 17, 1992); *id.* at H6489, H6492 (daily ed. July 23, 1992).

S. Rep. No. 92, 102d Cong., 1st Sess. 46-47 (1991) (*1991 Senate Report*); see also S. Rep. No. 456, 101st Cong., 2d Sess. 9 (1990) (*1990 Senate Report*) ("[B]ecause of concerns about the potential for anticompetitive practices by telephone companies and the need to ensure media diversity, the Committee is not now prepared to permit telephone companies to own or control video programming.").

5. Respondents then brought this action in district court, challenging the constitutionality of Section 533(b). Respondents (or their corporate affiliates) provide local exchange telephone services in six States and the District of Columbia, and they desire to provide video programming directly to subscribers in Alexandria, Virginia, where they have a monopoly on local exchange service. Pet. App. 54a, 77a n.17.

The district court granted summary judgment for respondents. It applied an "intermediate level of scrutiny," as set forth in *Ward* v. *Rock Against Racism*, 491 U.S. 781, 791 (1989), which requires that a content-neutral regulation of the time, place, and manner of speech be "narrowly tailored to serve a significant governmental interest" and "leav[e] open ample alternative channels for communication" to pass constitutional muster. See Pet. App. 94a. The district court found "little doubt that the statute leaves open ample alternative channels for communication," since LECs may, *inter alia*, communicate with subscribers by producing video programming and marketing it to broadcasters and cable operators.

The district court concluded, however, that Section 533(b) is not narrowly tailored because, in its view, there is a lack of "fit" between the statute and the objective of preventing anti-competitive conduct by LECs. Pet. App. 102a. The court accepted, *arguendo*, that regulatory controls would be insufficient to prevent LECs from cross-subsidizing affiliated cable entities. *Id.* at 106a. But the court stressed that, notwithstanding Section

533(b), LECs are permitted to operate systems for the *transport* of unaffiliated entities' video programming if they do not exercise control over the selection of that programming, and the court believed that the dangers of discrimination and cross-subsidization are also present in that permitted situation. Pet. App. 101a-102a. Although the government argued that incentives to anti-competitive conduct are enhanced if LECs select, as well as transmit, the video programming offered on a cable system, the court rejected that argument because, it believed, LECs have no "inherent advantage" in video programming that would permit them to evade regulation. *Id.* at 103a-104a.

6. The court of appeals affirmed. Pet. App. 1a-52a. The court of appeals held that Section 533(b) should be subject to intermediate scrutiny because it is not content-based (Pet. App. 28a), it is not intended to regulate or prohibit any speech because of the message that is conveyed (*id.* at 31a-32a), and it is "justified entirely by the peculiar economic and physical characteristics inherent in the provision of cable service" (*id.* at 34a).[10] Although the court agreed with the government that the interests served by Section 533(b) are significant (Pet. App. 38a-39a), it concluded that the statute is unconstitutional because it is not narrowly tailored. In reaching that conclusion, the court remarked that, because the statute contains no specific factual findings about the need for the particular measure enacted, it owed no deference to Congress's judgment on the question of narrow tailoring. *Id.* at 40a-41a.

The court of appeals first concluded that the threat of discrimination by LECs against their competitors in

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[10] The court of appeals thus rejected respondents' arguments for application of strict scrutiny (Pet. App. 37a) and the government's arguments for "minimal scrutiny" (*id.* at 20a-23a). Judge Michael declined to join the panel's rejection of strict scrutiny; he believed that, since the statute failed intermediate scrutiny, the question whether strict scrutiny should be applied was "academic." *Id.* at 52a.

affording access to utility poles and conduits was insufficient to support the cross-ownership bar. It reasoned that Congress could prohibit such discrimination rather than banning LECs from offering cable services. Pet. App. 42a. The court did not address the separate but related problem of LEC discrimination against competitors in access to the telephone network for transmission of video signals.

On the issue of cross-subsidization, the court of appeals assumed that regulatory oversight (in place of a cross-ownership bar) would be insufficient to prevent that abuse in the video transport market. It also assumed that the prospect of domination of the video programming market would give LECs an " 'irresistible' incentive" to cross-subsidize their video transport operations. Pet. App. 44a-45a. Nevertheless, the court found dispositive its perception that an "obvious less-burdensome alternative" to Section 533(b) exists: "Congress could simply limit [LECs'] editorial control over video programming [on any cable system] to a fixed percentage of the channels available; [LECs] would be required to lease the balance of the channels [to unaffiliated programmers] on a common carrier basis." Pet. App. 47a-48a.

Finally, the court concluded that Section 533(b) does not leave open ample alternative channels for communication by LECs. Pet. App. 49a-51a. Although the court recognized that LECs may freely arrange for their video programming to be distributed by broadcast stations and unaffiliated cable operators, it held the statute invalid because LECs "cannot *guarantee* that video programming they wish to transmit to their local audience via cable television * * * will reach their desired audience." *Id.* at 50a (emphasis added). It believed that Section 533(b) "ban[s] completely a particular manner of expression" to LECs. Pet. App. 51a.

7. On May 16, 1995, the FCC issued a Third Report and Order in its video dialtone rulemaking, in which it concluded that, under the "good cause" waiver provision

of Section 533(b)(4) (see p. 8, *supra*), it has "legal authority to grant waivers allowing [LECs] to provide video programming in their telephone service areas on video dialtone networks." Pet. Supp. App. 2a. Under its construction of Section 533(b)(4), the FCC "will routinely grant a waiver of [the cross-ownership bar] where the [LEC] agrees to abide by the regulations [that the FCC] will establish governing its provision of video programming." Pet. Supp. App. 19a. The FCC also explained that, because "the purpose of the rule is to promote competition," it will not grant waivers "to allow a [LEC] to purchase an incumbent monopolist cable operator in the [LEC's] service area" (*id.* at 16a); its reading of the waiver authority extends only "to permit a [LEC] to provide video programming over video dialtone systems in its telephone service area *in competition with* existing cable operators" (*id.* at 17a) (emphasis added).

The FCC noted that two courts of appeals and several district courts have concluded that Section 533(b) violates the First Amendment.[11] It also observed that this Court has instructed that "a statute is to be construed where fairly possible so as to avoid substantial constitutional questions." Pet. Supp. App. 6a (quoting *United*

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[11] The Ninth Circuit also declared Section 533(b) unconstitutional in two consolidated cases. *US West, Inc.* v. *United States*, 48 F.3d 1092 (1994); *Pacific Telesis Group* v. *United States*, 48 F.3d 1106 (1994). The statute has been held invalid by district courts in *NYNEX Corp.* v. *United States*, No. 93-323-P-C (D. Me. Dec. 8, 1994), appeal pending, No. 95-1183 (1st Cir.); *Ameritech Corp.* v. *United States*, 867 F. Supp. 721 (N.D. Ill. 1994), appeal pending, No. 95-1223 (7th Cir.); *BellSouth Corp.* v. *United States*, 868 F. Supp. 1335 (N.D. Ala. 1994), appeal pending, No. 94-7036 (11th Cir.); *United States Telephone Ass'n* v. *United States*, No. 1:94CV01961 (D.D.C. Feb. 14, 1995), appeal pending, No. 95-1175 (D.C. Cir.); *Southwestern Bell Corp.* v. *United States*, No. 3:94-CV-0193-D (N.D. Tex. Mar. 27, 1995), appeal pending, No. 95-10478 (5th Cir.); and *Southern New England Telephone Co.* v. *United States*, No. 3:94-CV-80 (DJS) (D. Conn. Apr. 27, 1995), appeal pending, No. 95-6137 (2d Cir.).

States v. *X-Citement Video, Inc.*, 115 S. Ct. 464, 467 (1994)). The FCC concluded that its interpretation of its waiver authority would "cure [the] constitutional infirmities" perceived in the cross-ownership bar (Pet. Supp. App. 6a n.11) and make it "unnecessary for [the] courts to decide whether a complete prohibition on video programming by [LECs] in their exchange areas is constitutional" (*id.* at 7a), for the LECs would henceforth be able to provide video programming directly to subscribers in their service areas.

The FCC addressed two statutory issues in construing Section 533(b)(4): whether there is "good cause" to waive the cross-ownership bar, and whether a waiver is "justified by the particular circumstances demonstrated by the petitioner, taking into account the policy of [the bar]." Pet. Supp. App. 9a. The FCC found two reasons to conclude that "good cause" exists to allow LECs to provide video programming over video dialtone systems. First, " '[g]ood cause' is a phrase that is commonly associated with changed circumstances" (*id.* at 11a), and the growth in the cable industry from "a fledgling service to a more mature industry" constitutes changed circumstances since Congress enacted the bar in 1984 (*id.* at 10a-11a). Second, "significant advances in technology" that now permit the dissemination of video signals over the telephone network "have made it possible for a multitude of programmers to reach end user customers and have mitigated to a fair degree the competitive concerns that led the Commission and Congress to adopt the cross-ownership ban." *Id.* at 11a-12a.

The FCC also concluded that waiving the bar to allow LECs to provide video programming on video dialtone networks would advance the policies of Section 533(b), competition and diversity in the market for video programming. The FCC emphasized that its video dialtone regulatory framework includes a common carriage element, such that a LEC offering video dialtone must make capacity available to other, unaffiliated video program-

mers. Thus, "[t]he common carrier aspect of video dialtone service promotes both competitive and free speech interests by making room for more than one speaker." Pet. Supp. App. 13a. The FCC also made clear that LECs would be allowed to offer video programming in their service areas only if they agree to abide by regulations that will be adopted to prevent anti-competitive abuses such as cross-subsidization and discrimination against competitors. *Id.* at 18a-19a.[12]

INTRODUCTION AND SUMMARY OF ARGUMENT

For more than two decades, there has been spirited debate over the costs and benefits of local telephone companies' entry into the market for cable services, as there has been debate over their participation in other lines of business, such as information services and long-distance services. The problems presented by the entry of LECs into other markets are substantial and complex, and the best mix of competition, regulation, and structural separation to address those problems has been the subject of sustained attention by Congress, the agencies that administer telecommunications laws, and the interests affected by regulation. Several participants in the debate,

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[12] Congress is also reexamining the cross-ownership bar at this time. On June 16, 1995, the Senate passed a bill that would repeal the cross-ownership bar and would expressly permit LECs to offer video programming through video dialtone systems. See S. 652, 104th Cong., 1st Sess. § 202 (1995); 141 Cong. Rec. S8570, S8577 (daily ed. June 16, 1995). On August 4, 1995, the House of Representatives passed a bill that would permit LECs to offer video programming to subscribers in their service areas, through video dialtone platforms operated by separate affiliates. See H.R. 1555, 104th Cong., 1st Sess. § 201 (1995); 141 Cong. Rec. H8436-H8438 (daily ed. Aug. 4, 1995). The House bill would require the FCC to issue regulations to prevent discrimination in access to the video dialtone system, and would permit state regulators to prevent cross-subsidization. See *id.* at H8437. The House bill would provide limited authority for LECs to invest in and control incumbent cable operators. *Id.* at H8438.

including federal agencies, have suggested that consumer welfare would ultimately be increased by freer LEC participation in the cable market—subject to appropriate regulatory safeguards and in conjunction with removal of barriers to competition in local telephone service. Congress, which is responsible for setting the nation's telecommunications policy, has nonetheless thus far declined to repeal the cross-ownership bar challenged in this case.

There are considerable advantages to the simple cross-ownership restriction enacted by Congress over the much more complex system of administrative supervision that would take its place, were the bar repealed or invalidated. Whether those advantages are outweighed by disadvantages of inefficiency is, of course, subject to much dispute. But that judgment is for Congress to make, and Congress's choice of a cross-ownership bar, which has undeniably been effective in preventing discrimination and cross-subsidization by LECs in the cable market, was a reasonable one. Whatever the arguments against the wisdom of the bar or its effectiveness in promoting competition, those arguments are not of constitutional dimension.

I. Section 533(b) does not require strict scrutiny. The cross-ownership bar is content-neutral; it reflects neither disagreement with any idea that would be expressed by LECs, nor any desire to suppress free expression. To the contrary, the bar is intended to keep channels of communication open by preventing private anti-competitive behavior that could choke off speech by LECs' competitors, and is justified entirely by reference to the economic consequences of LEC participation in the cable market. Section 533(b) is therefore subject at most to the intermediate scrutiny employed for regulations of the time, place, and manner of speech.

II. Section 533(b) survives intermediate scrutiny. The cross-ownership bar advances significant governmental interests in preventing anti-competitive conduct and promoting diversity of communications outlets. It accomplishes those objectives by forestalling LECs' extension of

their telephone monopoly to the cable market through cross-subsidization of their cable affiliates and discrimination against competitors in providing access to essential facilities (utility poles and conduits, and the modern telephone network) for the transmission of video programming. The bar is necessary and narrowly tailored to accomplish Congress's objectives, because it is easily administered and entirely effective. A less restrictive approach would require complex structural and accounting regulations and continual administrative supervision to monitor LECs' compliance with those rules. A regulatory approach also could not assure the same degree of effectiveness in preventing discrimination by LECs against competitors. The bar leaves open ample alternative channels of communication to LECs, which may disseminate video programming within their service areas by numerous other means (including broadcast television), operate cable systems outside their service areas, and use all non-video means of communication everywhere. The statute also gives the FCC authority to waive the bar for good cause to advance the goals of the statute, and in situations where cable service could not be provided except by LECs. The bar therefore applies only in those circumstances in which Congress reasonably concluded it is needed to prevent anti-competitive conduct by LECs.

III. The FCC's recent construction of its waiver authority to permit LECs to offer video programming on video dialtone systems removes any constitutional doubts about the statute. That construction permits LECs to provide video programming in their own service areas, in competition with incumbent cable operators. The construction therefore advances the statute's goals of diversity and competition while making more channels for dissemination of video programming available to LECs.

ARGUMENT

I. SECTION 533(b) DOES NOT REQUIRE STRICT SCRUTINY

We do not dispute that the dissemination of video programming by means of a cable system is "speech" protected by the First Amendment. Nevertheless, "not every interference with speech triggers the same degree of scrutiny under the First Amendment," and so the Court "must decide at the outset the level of scrutiny applicable" to the cross-ownership bar. See *Turner Broadcasting Sys.* v. *FCC*, 114 S. Ct. 2445, 2456 (1994). Respondents contend (Resp. 10-12) that Section 533(b) is a content-based restriction requiring strict scrutiny. In fact, the cross-ownership rule is a content-neutral regulation of the market for cable services aimed at the economic behavior of LECs, and it regulates only the manner and place in which LECs may disseminate video programming. It is therefore subject to review under the less rigorous, "intermediate" standard applicable to content-neutral time, place, and manner regulations. See *Turner*, 114 S. Ct. at 2469; *Ward* v. *Rock Against Racism*, 491 U.S. 781, 791 (1989); cf. *United States* v. *O'Brien*, 391 U.S. 367 (1968).

1. The "principal inquiry" in determining whether a regulation is content-based or content-neutral "is whether the government has adopted a regulation of speech because of disagreement with the message it conveys." *Ward*, 491 U.S. at 791. Under that inquiry, Section 533(b) is content-neutral. The restriction on LEC ownership of cable systems is unrelated to the content of any programming that LECs might offer, were they allowed to operate cable systems in their service areas. It is irrelevant to the statute whether the video programming that would be transmitted is "commercial or noncommercial, independent or network-affiliated, English or Spanish language, religious or secular." *Turner*, 114 S. Ct. at 2460.

Even if a regulation is facially content-neutral, it may also be treated as content-based if the government's "manifest purpose is to regulate speech because of the message it conveys." *Turner*, 114 S. Ct. at 2461. Section 533(b) is not motivated by hostility to any message, however, and the government's interests are entirely unrelated to the suppression of free expression. See *ibid.*; *Ward*, 491 U.S. at 791. Indeed, the objective of the cross-ownership restriction is to promote free expression through diversity of media outlets. See *1984 House Report* 33, 55; cf. *FCC* v. *National Citizens Comm. for Broadcasting*, 436 U.S. 775, 801 (1978) (*NCCB*). The statute recognizes that LECs, if unrestrained by regulation, have the ability and incentive to compete unfairly against other cable operators in the same geographical market, because of their physical control over essential facilities for the transmission of cable signals and their monoply power over local telephone service. That control could enable LECs to impede the dissemination of cable programming by their competitors. Cf. *Turner*, 114 S. Ct. at 2466 ("[S]imply by virtue of its ownership of the essential pathway for cable speech, a cable operator can * * * silence the voice of competing speakers."). Section 533(b), like the predecessor FCC rules, was designed "to insure against any arbitrary blockage of the gateway" (21 F.C.C.2d at 325), and Congress "[took] steps to ensure that private interests not restrict * * * the free flow of information and ideas" (*Turner*, 114 S. Ct. at 2466).

Respondents maintain that Section 533(b) is content-based because it regulates only the dissemination of "video programming," and because "video programming" is defined as "programming provided by, or generally considered comparable to programming provided by, a television broadcast station." 47 U.S.C. 522(19) (Supp. V 1993). As the court of appeals correctly observed (Pet. App. 26a-28a), however, the statute's reference to "video programming" distinguishes speech solely "on the

basis of the mode of delivery of the speech" (*id.* at 28a), and not its content. See *Regan* v. *Time, Inc.*, 468 U.S. 641, 656 (1984) (plurality opinion) (limitations on reproduction of currency "restrict only the manner in which the illustrations can be presented"). While LECs may not operate their own cable systems in their service areas, they may deliver the same video messages to those communities using broadcast television stations, direct broadcast statellite systems, unaffiliated cable systems, and videocassettes. They may also deliver messages to the public through newspapers, leaflets, and radio stations.

The FCC has interpreted the statutory definition of "video programming" to mean that "Congress intended to prohibit only [LEC] provision of programming comparable to that provided by broadcast television stations in 1984." *Video Dialtone Order*, 7 F.C.C. Rcd at 5820. As so construed, the statute distinguishes the one-way, non-interactive television technology familiar to Congress in 1984 from other forms of speech that were under development at the time and were preserved for LECs, such as interactive video and videotext. See *id.* at 5820-5823; *1984 House Report* 57 ("[N]othing in this section shall be construed to limit [LEC] provision of information services or other non-video programming."). The statutory definition of "video programming" does not, however, contain any reference to the subject matter of television programs, and the FCC has not construed it to include any element of content.[13]

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[13] Given the "abundant discretion" that television licensees retain over programming choices, as well as the breadth of programming that was disseminated on television in 1984, it would be difficult to interpret the Act's reference to "video programming" to include any element of content. Cf. *Turner*, 114 S. Ct. at 2464. But even if the statutory reference to "video programming" is ambiguous, the FCC's construction of it to include a technological distinction, but not an element of content, is entitled to deference. See *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844-845 (1984). Deference to the FCC's construction is par-

As multimedia speech develops, instances may arise in which it will be difficult to determine whether a certain series of video images is "comparable to" television broadcasting. See *Video Dialtone Order*, 7 F.C.C. Rcd at 5820-5821. But even if one must examine the images to determine whether they come within the scope of Section 533(b), that would not make the bar content-based. The focus of the inquiry is on the manner in which the message is presented, and not on the ideas expressed in the message. Cf. *Ward*, 491 U.S. at 792-793 (noting that city had disclaimed "any interest in imposing its own view of appropriate sound mix on performers," and that its interest extended only to "the clearly content-neutral" goal of reducing noise).

Finally, as the district court noted (Pet. App. 88a-93a), even a regulation of speech that contains an element of content distinction does not require strict scrutiny if the regulation is "*justified* without reference to the content of the regulated speech." *City of Renton* v. *Playtime Theaters, Inc.*, 475 U.S. 41, 48 (1986); *Ward*, 491 U.S. at 791. In determining whether strict scrutiny is necessary, "[t]he government's purpose is the controlling consideration." *Ibid.* Under that inquiry as well, Section 533(b) does not require strict scrutiny, for its justification is unrelated to the content of any message that would be disseminated. The purpose of Section 533(b) is the prevention of certain well-known economic practices that present a danger to free expression and competition—not "[the] suppress[ion] * * * of unpopular views." *Renton*, 475 U.S. at 48. The statute "is neutral—indeed it is silent—concerning any speaker's point of view." *Members of City Council* v. *Taxpayers for Vincent*, 466 U.S. 789, 803-804 (1984).

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ticularly appropriate in this case because it avoids the constitutional questions that would be created if the statute were construed to include a content-based distinction. Cf. *Jean* v. *Nelson*, 472 U.S. 846, 855-856 (1985).

2. Nor is Section 533(b) subject to strict scrutiny on the theory that it is a "direct ban on speech as such." Resp. 10. Content-neutral regulations of speech are subject only to intermediate scrutiny, "even though they directly limit oral or written expression." See *Clark* v. *Community for Creative Non-Violence*, 468 U.S. 288, 298 n.8 (1984). For example, in *Frisby* v. *Schultz*, 487 U.S. 474 (1988), in which the Court upheld an ordinance banning picketing in front of residences, the Court observed that the prohibition was content-neutral (*id.* at 481-482), and it applied the "intermediate" standard of review applicable to content-neutral regulations (see *id.* at 482 (inquiring whether the ordinance was "narrowly tailored to serve a significant government interest" and whether it "[left] open ample alternative channels of communication"); *id.* at 492-493 (Brennan, J., dissenting) (agreeing that the residential picketing ban was "subject to the well-settled time, place, and manner test")). Cf. *Ward*, 491 U.S. at 791 (applying same test); *Clark*, 468 U.S. at 293 (same). In *Vincent*, the Court applied a similar test, drawn from *United States* v. *O'Brien*, *supra*, to the content-neutral prohibition on the posting of signs at issue in that case. See 466 U.S. at 804-805, 808.[14]

As a content-neutral regulation of the market for cable services, Section 533(b) must therefore be analyzed under the intermediate standard of scrutiny applicable to time, place, and manner regulations. The statute is not a blanket ban on speech by LECs; it prohibits them from operating cable systems only in the areas where they offer local telephone service. In all other areas, where the

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[14] Thus, notwithstanding respondents' argument that the *O'Brien* test "has been reserved exclusively for regulations having only an 'incidental' effect" on speech (Resp. 10), it is clear that the *O'Brien* test "in the last analysis is little, if any, different from the standard applied to time, place, or manner restrictions." *Clark*, 468 U.S. at 298; see *id.* at 298 n.8; *Turner*, 114 S. Ct. at 2469.

dangers of anti-competitive conduct by LECs are not present, they are free to offer cable service. The statute also regulates only speech in video form, and not the various other modes of speech that could deliver the same message. Cf. *Frisby*, 487 U.S. at 484 (observing that, although protesters could not engage in residential picketing, they could distribute literature and contact residents by telephone). Finally, the statute regulates only video programming delivered by means of cable systems—not video programming disseminated by all other possible means, including broadcast television, satellite television, and videocassettes. The court of appeals correctly concluded, therefore, that Section 533(b) is subject to "intermediate scrutiny." Pet. App. 38a.

II. SECTION 533(b) MEETS THE REQUIREMENTS OF INTERMEDIATE SCRUTINY

A. Section 533(b) Furthers Significant Governmental Interests

A content-neutral regulation of speech is valid if it is "narrowly tailored to serve a significant governmental interest, and * * * leav[es] open ample alternative channels for communication of the information." *Ward*, 491 U.S. at 791. The court of appeals correctly concluded that the interests served by Section 533(b) are significant. See Pet. App. 38a-39a. In *Turner*, this Court made clear that "the Government's interest in eliminating restraints on fair competition is always substantial," as is "assuring that the public has access to a multiplicity of information sources, [which] promotes values central to the First Amendment." 114 S. Ct. at 2470. With respect to the cable market in particular, *Turner* also established that the government has a substantial interest in "ensur[ing] that private interests not restrict, through physical control of [the] critical [bottleneck] of [cable] communication, the free flow of information and ideas," *id.* at 2466,

an interest directly relevant to LECs' control over physical facilities for the transmission of cable signals.

Nor can there be doubt that Section 533(b) actually furthers those significant interests. Cross-ownership restrictions have long been used by regulators to curtail the potential for abuse of market power and to encourage diversity in holdings.[15] The utility of such rules to prevent cross-subsidization by monopolists seeking to enter competitive markets has also been borne out by the courts' experience with the antitrust suit that resulted in the breakup of the Bell System. Cross-subsidization by LECs formerly affiliated with the Bell System has been a principal issue throughout that litigation, in which the district court found that exclusion of those LECs from certain lines of business was necessary to prevent anti-competitive conduct by them.[16] Section 533(b) is also effective at preventing LECs from abusing their control over facilities to discriminate against competitors. By completely excluding LECs from cable programming in their service areas, the bar removes the incentive for them to discriminate against their competitors in that business.

The district court suggested (Pet. App. 102a-104a), however, that Section 533(b) cannot prevent anti-competitive behavior by LECs because the bar does not prohibit them from *transporting* video signals over cable systems to subscribers, as long as they do not also participate in the selection of the video programming

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[15] See, *e.g.*, Public Utility Holding Company Act of 1935, 15 U.S.C. 79a(a) and (b); Bank Holding Company Act of 1956, 12 U.S.C. 1841 *et seq.*; see also *NCCB, supra* (upholding FCC restrictions on cross-ownership of newspapers and broadcast stations in same community); *United States* v. *Storer Broadcasting Co.*, 351 U.S. 192, 193 (1956) (upholding FCC regulation limiting number of broadcast licenses that any one person could acquire).

[16] See *1984 House Report* 32-33; *United States* v. *American Tel. & Tel. Co.*, 524 F. Supp. at 1368-1369; *United States* v. *American Tel. & Tel. Co.*, 552 F. Supp. at 188-191.

transmitted over the cable systems.[17] The district court questioned why Congress would have allowed LECs to participate in the video transport market, if it was concerned about the misallocation of costs of facilities common to telephone and video *transport* operations. See Pet. App. 103a-104a & n.31.

The district court failed to appreciate several points about the justification for Section 533(b). First, as the 1981 FCC staff report noted (J.A. 56 n.34), LECs' incentive and ability to cross-subsidize are significantly diminished when they transport video programming in the manner of common carriers for unaffiliated entities. State regulators can limit LECs' revenues from such operations under traditional rate-of-return principles applicable to common carriers.

Second, the lucrative video programming market makes entry into the cable business particularly attractive to LECs. Once in that market, LECs could compete unfairly through their ability to cross-subsidize their video transport facilities. The evidence presented to the district court established that LECs' incentives to cross-subsidize and to discriminate would be "greatly enhanced if [they] are also allowed to exploit monopoly control of video transmission by earning excess profits in video programming." J.A. 332 (Owen reply affidavit). See also C. Edwin Baker, *Merging Phone and Cable*, 17 Hastings Comm. & Ent. L.J. 97, 133 (1994) ("If allowed to provide programming, [LECs'] power in the video transport market would allow them to exercise undue power in the

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[17] The FCC has consistently taken the position that the cross-ownership bar does not prohibit LECs from offering "channel service," under which LECs may build and operate cable facilities for the physical transport of video signals but play no role in the selection of the video programming offered on those facilities. *Further Notice of Inquiry*, 3 F.C.C. Rcd at 5857. In essence, a LEC offering channel service owns the cable system but leases it to unaffiliated cable operators.

video programming market and would increase the value to the phone company of monopolizing transport."). The FCC has also recognized that Section 533(b) protects "competition in the provision of [cable] services and facilities" (*i.e.*, programming and transmission) by "surely reduc[ing] [LECs'] incentive and ability to engage in anti-competitive conduct in [their] service areas." *Further Notice of Inquiry*, n.8, *supra*, 3 F.C.C. Rcd at 5864. Therefore, the fact that Section 533(b) permits LECs to enter the video transport market without control over programming is not a flaw in the economic theory underlying the cross-ownership bar, but a recognition that there is less opportunity or incentive for anti-competitive behavior when LECs are confined to carrying others' programming in a role similar to their traditional one as common carriers. See Baker, *supra*, at 132 ("As long as the phone company cannot itself offer cable programming, it has no incentive to drive cable companies out of business.").

B. Section 533(b) Is Narrowly Tailored

1. The court of appeals invalidated Section 533(b) because it concluded that a less restrictive alternative would be equally effective to prevent anti-competitive behavior by LECs; it suggested that the cross-ownership bar could be replaced by an arrangement under which LECs would be permitted to operate a cable system but would be restricted to editorial control of a fixed percentage of the channels on that system. Pet. App. 47a-48a. The court of appeals also criticized Congress and the FCC for not making any "underlying factual findings" to support their implicit conclusion that less sweeping regulatory alternatives would not effectively achieve the government's interests. *Id.* at 45a-47a. In the absence of such findings, the court declined to "accede to Congress' judgment" that the bar is necessary to achieve those interests. *Id.* at 40a-41a.

The court of appeals' disagreement with Congress's choice of a cross-ownership bar cannot be reconciled with this Court's "intermediate scrutiny" decisions, which require considerably more deference to Congress's judgment that the particular approach chosen for the regulation of the cable market is necessary to prevent anti-competitive abuse effectively. See *Clark*, 468 U.S. at 299. This Court has made clear that a content-neutral regulation "need not be the least restrictive or least intrusive means of [achieving the government's interest]. Rather, the requirement of narrow tailoring is satisfied 'so long as the . . . regulation promotes a substantial government interest that would be achieved less effectively absent the regulation.' " *Ward*, 491 U.S. at 798-799 (footnote omitted); *Turner*, 114 S. Ct. at 2469-2470.

The Court has also stressed that it is "loath to second-guess the Government's judgment" of narrow tailoring. See *Board of Trustees* v. *Fox*, 492 U.S. 469, 478 (1989). Thus, what narrow tailoring requires in this context is a " 'fit' between the legislature's ends and the means chosen to accomplish those ends,' a fit that is not necessarily perfect, but reasonable; that represents not necessarily the single best disposition but one whose scope is 'in proportion to the interest served[.]' * * * Within those bounds [the courts must] leave it to governmental decisionmakers to judge what manner of regulation may best be employed." *Id.* at 480 (citations omitted).[18] Given the difficulty of finding a solution to the economic problems that Congress perceived in LEC participation in the cable market, the First Amendment affords Congress "a

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[18] Although *Fox* was a commercial speech case, that decision states that the requirement of narrow tailoring for regulation of commercial speech is "substantially similar" to the same requirement for content-neutral time, place, and manner regulations of non-commercial speech. 492 U.S. at 477-478; see *San Francisco Arts & Athletics, Inc.* v. *United States Olympic Comm.*, 483 U.S. 522, 537 n.16 (1987).

reasonable opportunity to experiment with solutions to admittedly serious problems." *Renton*, 475 U.S. at 52.

The courts' obligation not to "second-guess" Congress does not depend on the presence of factual findings in the statute or the legislative history that the bar is necessary, as the court of appeals seemed to think (see Pet. App. 40a-41a, 45a). In cases like this one, the question for the courts is whether the regulation of speech is reasonably necessary to advance any significant interest of the government, not whether the enacting Congress expressly found it to be necessary. "Congress is not obligated, when enacting its statutes, to make a record of the type that an administrative agency or court does to accommodate judicial review." *Turner*, 114 S. Ct. at 2471 (plurality opinion).[19] Therefore, the question of narrow tailoring is not whether Congress expressly found that Section 533(b) is necessary to achieve the government's interests effectively, but whether the economic and predictive judgments underlying Section 533(b) are reasonable to support such a conclusion. See *id.* at 2473 (Stevens, J., concurring in part and concurring in the judgment) ("But the question for us is merely whether Congress *could fairly conclude* that cable operators' monopoly position threatens the continued viability of broadcast television and that must-carry is an appropriate means of minimizing that risk.") (emphasis added and omitted).

2. Under the proper standards, Section 533(b) is narrowly tailored, and the court of appeals' reliance on what it believed to be a less restrictive alternative was an

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[19] Indeed, in arguing that a regulation is narrowly tailored, the government may rely on evidence and arguments that were not presented to the enacting Congress, just as it may advance interests to support a regulation of speech that were not considered when the regulation was enacted. See *Bolger* v. *Youngs Drug Products Corp.*, 463 U.S. 60, 70-71 (1983); *Ohralik* v. *Ohio State Bar Ass'n*, 436 U.S. 447, 460 (1978).

inappropriate substitution of its judgment for Congress's policy decision. The restriction is not "substantially broader than necessary" to achieve the government's interests. *Ward*, 491 U.S. at 800. Section 533(b) restricts LECs' provision of video programming only in the specific situation in which Congress identified a potential for anti-competitive behavior. LECs remain free to speak to subscribers in their service areas by a variety of means that do not present that danger. They may, for example, operate local television broadcast stations, which would be carried over local cable systems, by virtue of the 1992 Cable Act's must-carry rules. See 47 U.S.C. 534(a) (Supp. V 1993); *Turner*, 114 S. Ct. at 2453. They may produce their own video programming and offer it to local cable operators for transmission, and may also gain access to cable systems for their speech through the "leased access" provisions of the Cable Act (47 U.S.C. 532 (1988 & Supp. V 1993)). The Cable Act also does not prevent them from operating traditional cable systems anywhere *outside* their own service areas.

In addition, the Cable Act does not prohibit LECs from operating direct broadcast satellite systems (which can provide hundreds of channels of video programming) or microwave-based multichannel "wireless cable" systems anywhere in the country, including their own service areas. See *In re Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992: First Report*, 9 F.C.C. Rcd 7442, 7473-7478 (1994); *American Scholastic TV Programming Found. v. FCC*, 46 F.3d 1173 (D.C. Cir. 1995). The Cable Act also preserved, for LECs, the potential for dramatically increased speech opportunities in their service areas and elsewhere through the development of interactive and multimedia services. *Video Dialtone Order*, 7 F.C.C. Rcd at 5788, 5822-5823; see also *1984 House Report* 57. Finally, the statute permits the FCC to waive the bar in situations in which cable service could not

exist except through LECs, and also for "good cause" to advance the policies of the statute as a whole. 47 U.S.C. 533(b)(4). Congress has therefore done no more than to address "the exact source of the evil it sought to remedy." *Vincent*, 466 U.S. at 808.

3. Congress reasonably concluded that the cross-ownership bar is necessary to prevent cross-subsidization by LECs in the cable market effectively. The only alternative to a restriction like Section 533(b) would be a complex set of structural and accounting rules imposed and enforced by the FCC to ensure that LECs do not subsidy transfer costs from their cable affiliates to their telephone operations.[20] Whether or not it would be *possible* to prevent cross-subsidization through such rules, if the FCC were given adequate resources to monitor LECs effectively, that approach does have significant disadvantages, such that Congress could reasonably choose a cross-ownership bar instead. The regulatory task of containing cross-subsidization through accounting rules is decidely complex. The inherent subjectivity of cost accounting issues that would have to be addressed under a regulatory approach, the ongoing possibility of evasion of, and litigation over, accounting rules set by the FCC, and the need for substantial auditing resources sufficient to prevent evasion all support Congress's choice of a simpler approach to the problem of unfair cost-shifting. See J.A. 54-58 (1981 FCC staff study, doubting feasibility of regulatory solution to cost-shifting), 83-85, 88-90 (General Accounting Office (GAO) Report detailing practical and conceptual difficulties in containing cost-shifting), 124-131 (second GAO Report, stressing need for adequate auditing resources), 234-236 (Robinson affidavit,

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[20] Cf. *California v. FCC*, 905 F.2d 1217 (9th Cir. 1990) (reviewing FCC rules to contain such abuse by LECs in information services market); *United States v. Western Elec. Co.*, 900 F.2d at 288-298 (considering adequacy of such rules to justify modification of Bell System consent decree).

stressing complexity of accounting rules), 266-268 (Owen affidavit, stressing same).[21]

Congress drew the "reasonable inferenc[e]" that the bar is necessary from "substantial evidence." *Turner*, 114 S. Ct. at 2471 (plurality opinion). Congress enacted Section 533(b) in 1984 against a background that included the 1981 FCC staff study and the recent

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[21] Respondents have pointed out that the FCC and other agencies have recommended that Congress replace the cross-ownership bar with regulatory safeguards such as accounting rules and structural separation of telephone and cable affiliates, and have suggested that those safeguards would be adequate to prevent cross-subsidization. The FCC and the Department of Justice, relying in part on regulatory safeguards, also supported modification of the Bell System antitrust consent decree to remove the prohibition on provision of information services by the former Bell-System LECs. See J.A. 337-360; *United States* v. *Western Elec. Co.*, 993 F.2d 1572 (D.C. Cir.), cert. denied, 114 S. Ct. 487 (1993). Those agencies have not stated, however, that there would be *no* risk of discrimination or cross-subsidization if LECs were permitted to provide video programming, or that reasonable minds could not differ about the need for exclusion from a market, rather than regulatory safeguards, to prevent anti-competitive abuse effectively. Cf. *National Rural Telecom Ass'n*, 988 F.2d at 180 (noting FCC's acknowledgment that various regulatory alternatives are not "ironclad guarantees against cost shifting"). The FCC has concluded, rather, that the risk of abuse by LECs in the cable market is outweighed by the potential benefits served by their entry into that market (*Video Dialtone Order*, 7 F.C.C. Rcd at 5849), and it continues to believe that some regulatory safeguards would be necessary to contain abuses by LECs (*id.* at 5847-5851). See also Statement of Assistant Attorney General Anne K. Bingaman Before the Senate Commerce Committee 14-17 (Mar. 2, 1995) (lodged with the Clerk) (stressing that restrictions on LECs' competition with cable systems should be removed in conjunction with restrictions on competition by cable systems and others in provision of local telephone service). Nor is it unusual for federal agencies and Congress to disagree about the costs and benefits of a particular policy. Since the issue in this case is the permissibility of *Congress's* predictive judgment that exclusion from the cable market is necessary to prevent abuse by LECs, that is the judgment to which the courts owe substantial deference. See pp. 27-29, *supra*.

breakup of the Bell System. Its decision to exclude LECs from the cable market relied on the district court's conclusion in the Bell antitrust suit that exclusion of the Bell-System LECs from other lines of business was necessary to prevent cross-subsidization. See *1984 House Report* 33. When Congress returned to the issue in the late 1980s and early 1990s, it had a warning from the GAO about serious practical difficulties in containing cross-subsidization of new lines of business by LECs. See J.A. 79-101. Congressional committees also heard testimony from parties opposing repeal of the bar that regulation could not effectively prevent LECs from engaging in anti-competitive behavior, and that entry of LECs into the cable services market would exacerbate structural problems with that market.[22] Those interests also brought to Congress's attention the first GAO Report and court decisions calling into question the efficacy of alternative

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[22] *Cable-Instructional TV and S. 1200, Communications Competitiveness and Infrastructure Modernization Act of 1991: Hearing Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science, and Transportation*, 102d Cong., 2d Sess. 115-139 (1992); *Cable Television Regulation: Hearings Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 102d Cong., 1st Sess. 206-211, 538-602, 617-635, 699-704, 727-745 (1991); *Communications Competitiveness and Infrastructure Modernization Act of 1990: Hearing Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science, and Transportation*, 101st Cong., 2d Sess. 61-84, 89-125, 126-134, 177-194 (1990); *Cable TV Consumer Protection Act of 1989: Hearings Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science, and Transportation*, 101st Cong., 2d Sess. 238-239, 341-355, 559-560 (1990); *Cable Television Regulation (Part 1): Hearings Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 101st Cong., 2d Sess. 436-451, 464-474 (1990); *Cable Television Regulation (Part 2): Hearing Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 101st Cong., 2d Sess. 98-99, 114-121 (1990).

safeguards such as accounting rules.[23] The Senate Commerce Committee, which in 1990 examined in detail the arguments for and against repeal of Section 533(b), concluded it "could not at the present time support repeal[,] * * * because of concerns about the potential for anti-competitive practices by telephone companies and the need to ensure media diversity." *1990 Senate Report* 8-9; see also *1991 Senate Report* 46-47.[24]

Given the difficulties in monitoring cost-shifting by LECs, the court of appeals understandably accepted, *arguendo*, that accounting safeguards would not be sufficient to prevent that abuse. Pet. App. 45a; see *id.* at 106a (same assumption by district court). Nevertheless, the court of appeals suggested that "Congress could simply limit [LECs'] editorial control over video programming to a fixed percentage of the channels available; [LECs] would be required to lease the balance of the channels on a common carrier basis to various video programmers, without regard to content." *Id.* at 47a-48a. That suggestion does not solve the problem identified by Congress, however, because LECs could still transfer the

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[23] *Cable Television Regulation: Hearings Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 102d Cong., 1st Sess. 633, 743 (1991); *Communications Competitiveness and Infrastructure Modernization Act of 1990: Hearing Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science, and Transportation*, 101st Cong., 2d Sess. 62, 69, 96-97, 119-120 (1990).

[24] Regulators continue to find evidence of cost-shifting by LECs. A 1988 FCC audit tentatively concluded that NYNEX Corporation had engaged in a pattern of cross-subsidization of unregulated affiliates involving more than $100 million. *In re New York Tel. Co.*, 5 F.C.C. Rcd 866, 866-869 (1990). NYNEX later entered into a consent decree with the FCC, in which it admitted no liability but agreed to make adjustments to its books and to make a voluntary contribution of $1,419,000 to the United States Treasury. *In re New York Tel. Co.*, 5 F.C.C. Rcd 5892 (1990). See also J.A. 260-262 (Owen affidavit, describing similar findings of LECs' cross-subsidization by state utility regulators).

costs of their cable operations to their monoply telephone operations. See J.A. 68-69 (FCC staff report). Their incentive to do so would grow in proportion to their editorial control over programming carried over their cable system. See *ibid.* ("[T]he higher the level [of LEC control over cable channels], the greater is the danger from telephone monopoly power."). The court's suggestion would actually magnify the complexity of the accounting problems, because LECs would have to separate their costs attributable to their telephone and cable operations, and also their costs attributable to the portions of the cable system over which they did, and did not, maintain editorial control. Finally, choosing the precise percentage of editorial control over a cable system that would simultaneously contain LECs' incentive to cross-subsidize but also ensure them adequate channels of communication would be difficult, and the court's suggestion would relegate Congress and the FCC to a process of continual trial and error to accommodate those concerns.

4. It is also reasonable to conclude that the cross-ownership bar is necessary to prevent LECs from abusing their control over the poles and conduits essential to the operation of a cable system (as the FCC concluded in 1970),[25] and from discriminating against competitors using the modern telephone network to transmit video programming. The court of appeals rejected the government's interest in preventing discrimination as a justification for the bar, reasoning that Congress could pass legislation to prohibit discrimination by LECs. Pet. App. 42a. Prohibiting discrimination is hardly the same thing as effectively preventing it, however. Even if Congress did replace Section 533(b) with the legislation suggested

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[25] When it implemented the cross-ownership bar, the FCC noted that "numerous parties" had complained about discriminatory conduct by LECs in providing access to utility poles for the construction of cable television systems. *1970 FCC Rules*, 21 F.C.C.2d at 324.

by the court of appeals, LECs' control over the facilities used in transmitting video programming would still give them great economic power over competitors needing those facilities that could be abused. It could be difficult for regulators to prove discrimination, and even to develop less restrictive prophylactic rules to prevent it. See J.A. 73-74 (FCC staff study); 231-233 (Robinson affidavit, discussing difficulties in preventing discrimination by LECs in access to their facilities).

For example, a typical licensing agreement between respondents' Virginia LEC and a cable carrier granting access to the LEC's poles and conduits gives the telephone company discretion to determine whether space is available on a pole and conduit system for cable attachments, to refuse access if it would interfere with the quality of telephone communications or other utility facilities already in place, and to decide exactly where cable attachments should be placed. The cable operator is also required to obtain the LEC's permission to carry out maintenance of the cable attachments. J.A. 104, 108, 109-110. LECs could abuse such provisions to frustrate their competitors' ability to reach their customers and to keep their equipment adequately maintained, even though the provisions might appear proper to allow LECs to maintain the quality of their own equipment.

In the case of access to the telephone network for transmission of video programming, the threat of LEC discrimination against competitors could be even more severe and elusive, for LECs have much greater expertise in the operation of that technically complex network than do their competitors. LECs could use their control over the network to ensure that the quality of their own video signals is better than that of their competitors. Also, because programmers intending to use the telephone network to transmit video signals must coordinate their use of the network with the LEC that controls it, the LEC could use its position to learn its competitors' marketing

plans and other proprietary information. See J.A. 268-269 (Owen affidavit); cf. *California* v. *FCC*, 39 F.3d 919, 927-931 (9th Cir. 1994) (stressing danger of such discrimination in LECs' participation in information services market).

While a law prohibiting discrimination might declare such practices illegal, it could be difficult for competitors or the government to prove that LECs had abused their control over telecommunications facilities in any particular case, and an extensive supervisory administration could be necessary to police LECs' control over the network, poles, and conduit space. See J.A. 230-231 (Robinson affidavit, noting "formidable complexity" of the task). Even if it is *possible* to prevent such discrimination through promulgation and enforcement of complex technical specifications, those methods have such disadvantages in implementation and effectiveness that it was reasonable for Congress to have chosen a cross-ownership bar instead. See *Ward*, 491 U.S. at 800. A bar on LEC ownership of cable systems in their service areas requires little administrative supervision, and it is completely effective in preventing discrimination. By excluding LECs from the local cable market, it removes entirely their incentive to discriminate against competitors in the cable business.

C. LECs Have Ample Alternative Channels Of Communication

As the district court observed, LECs "are by no means 'silenced' by the operation of [Section] 533(b)." Pet. App. 94a. While LECs are precluded from operating cable systems within their service areas, they may purchase or operate local broadcast television stations (and even national television networks that do not own cable systems in their service areas), establish multichannel direct broadcast satellite systems, and create program-

ming for cablecast on cable channels carried by unaffiliated cable systems. They may also operate cable systems outside their common-carrier service areas. See pp. 30-31, *supra*. The assertion that Section 533(b) excludes LECs from "an entire medium of expression" (Resp. 8 n.9) is incorrect.

The court of appeals believed, however, that Section 533(b) is invalid because LECs "cannot *guarantee* that video programming they wish to transmit * * * will reach their desired audience." Pet. App. 50a (emphasis added). In fact, LECs can effectively reach a broad audience in any community by operating a local broadcast television station, which would be carried over cable systems under the 1992 Cable Act's must-carry rule, or by operating a direct broadcast satellite system. See p. 30, *supra*. But in any event, the Court has rejected the contention that the First Amendment includes a "guarantee" of reaching an audience in a particular way. In *Heffron* v. *International Society for Krishna Consciousness, Inc.*, 452 U.S. 640 (1981), the Court upheld a restriction limiting the distribution of religious literature and solicitation of funds at a fairground to designated locations, even though the religious organization maintained that its proselytizing could be done successfully "only by intercepting fair patrons as they move about." *Id.* at 653. In light of the "alternative forums for the expression of * * * protected speech" that existed both within and outside the fairgrounds (*id.* at 654-655), the Court concluded that the restriction was valid. LECs may similarly communicate their messages to the general public in video format, both within and outside their service areas; only one mode of delivery in specific places is denied to them, because of the potential anti-competitive economic consequences of their using that mechanism in those places. There is no "barrier to delivering to the media, or to the public by other means" (*Clark*, 468 U.S. at 295), any message that LECs wish to disseminate.

III. THE FCC'S THIRD REPORT AND ORDER ELIMINATES ANY DOUBTS ABOUT THE CONSTITUTIONALITY OF SECTION 533(b)

As we have argued, a restriction on LECs' participation in the cable market in their service areas satisfies the First Amendment, and the court of appeals' decision to the contrary was erroneous. Even if we assume, however, that a flat ban on LECs' provision of video programming on cable systems in their service areas would contravene the First Amendment, the FCC's Third Report and Order (Pet. Supp. App. 1a-21a), authoritatively construing the waiver authority delegated to it by Congress in Section 533(b)(4), eliminates the constitutional objections to the statutory regime raised by the court of appeals. The FCC's construction of Section 533(b)(4), which was not available to the court of appeals,[26] makes clear that Section 533(b), as a whole, is narrowly tailored and leaves open ample channels of communication to LECs. It therefore provides additional grounds for reversal of the judgment below.

1. In the Third Report and Order, the FCC construed the waiver authority to permit a substantial entry by LECs into the video programming market. See pp. 13-16, *supra*. Under that construction, LECs may provide their own video programming directly to subscribers in their telephone service areas, if that programming is delivered by means of a video dialtone system in competition with an incumbent cable operator. Pet. Supp. App. 9a, 16a-17a. The FCC has initiated the process of designing regulatory safeguards to prevent cross-subsidization and discrimination by LECs in video dialtone services, *id.* at 14a n.35, and it will "routinely" grant waivers of the cross-ownership bar, under Section 533(b)(4), to LECs that

[26] For that reason, we suggested at the petition stage that the Court vacate the judgment of the court of appeals and remand the case to that court for further consideration (Pet. Supp. Br. 7).

agree to abide by those safeguards in their video dialtone systems, Pet. Supp. App. 19a.

The FCC observed that Section 533(b)(4) gives it authority to grant waivers for "good cause," a phrase that is "commonly associated with changed circumstances." Pet. Supp. App. 11a. It concluded that the growth of the cable industry and the dramatic technological advances in the delivery of video programming since 1984 are "changed circumstances" sufficient to constitute "good cause," within the meaning of the statute. It also found that those changed circumstances have mitigated the threat to competition that animated the cross-ownership bar to such a degree that greater entry by LECs into the video programming market will not undermine the objectives of the statute as a whole. *Id.* at 11a-12a.

Indeed, the FCC concluded that a construction of Section 533(b)(4) to permit LECs to provide video programming on video dialtone networks will advance the policies of Section 533(b)—competition and diversity in communications. Pet. Supp. App. 13a. The FCC noted that its video dialtone regulatory framework requires a common carriage element, such that LECs offering video dialtone service must make capacity available to other, unaffiliated programmers. Thus, it concluded, LEC provision of video dialtone "promotes both competitive and free speech interests by making room for more than one speaker." *Ibid.*

The FCC also rested its construction of Section 533(b)(4) on the fact that the construction obviates the purported constitutional problems that the courts have identified in Section 533(b). Pet. Supp. App. 14a-16a. Heeding this Court's admonition that "a statute is to be construed where fairly possible so as to avoid [substantial] constitutional questions," *id.* at 16a (quoting *United States* v. *X-Citement Video, Inc.*, 115 S. Ct. 464, 467 (1995)), the FCC concluded that its reading of the statute, by permitting greater LEC participation in video

programming, would "eliminate [the constitutional] doubts" that have been suggested but would not be "plainly contrary to the intent of Congress." *Ibid.* (quoting *X-Citement Video*, 115 S. Ct. at 472).

Finally, the FCC noted that its construction does not raise any of the constitutional concerns that have been associated with waiver provisions in other First Amendment contexts. See Pet. Supp. App. 17a-18a. It stressed that its construction does not lodge any discretion in any official to grant or deny a waiver based on the content of the speech, but rather provides blanket authorization to offer programming by video dialtone, upon compliance with regulations to be published that will be designed to prevent anti-competitive conduct. Accordingly, the FCC observed, there is no "threat of censorship that by its very existence chills free speech." *Id.* at 18a-19a.

2. The FCC's authoritative construction of Section 533(b)(4) removes the constitutional doubts about Section 533(b) that were raised by the court of appeals. Under the operation of the statute as a whole, including Section 533(b)(4) as now interpreted, LECs will "have abundant opportunities to speak." Pet. Supp. App. 15a. The FCC has established that the door is open for LECs to use their video dialtone systems in the manner of a cable system, to distribute multiple channels of their own programming, as well as the programming of others, selected with editorial control. While its construction does not permit LECs to take over incumbent monopolist cable operators (*id.* at 16a-17a), that limitation does not prevent LECs from offering, on a video dialtone system, the same programming that could be offered on a traditional cable system. LECs therefore have "ample alternative modes of communication" at their disposal. *Vincent*, 466 U.S. at 812.[27]

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[27] The limitation is also consistent with the statute's goal of (and Congress's significant interest in) preventing the extension

The FCC's construction also removes any objections to the tailoring of the congressional regime. LECs may enter the market for distribution of multichannel video programming, on the condition that they also set aside a significant portion of the video dialtone network for distribution of other programmers' video speech on a common carriage basis. Pet. Supp. App. 14a-15a. That is precisely the "obvious less-burdensome alternative" identified by the court of appeals as preferable to Congress's exclusion of LECs from the cable market. See Pet. App. 47a-48a.

Given their opportunity to disseminate video programming on video dialtone networks, respondents cannot, as defenders of the court of appeals' facial invalidation of the statute, "establish that no set of circumstances exists under which [Section 533(b)] would be valid." *United States* v. *Salerno*, 481 U.S. 739, 745 (1987). Under the FCC's waiver authority, moreover, respondents will obtain their principal objective, the ability to develop a video dialtone system on their own telephone network for the transmission of their own programming. See J.A. 13, 15 (complaint). What LECs have not obtained through the FCC's construction of its waiver authority is the right to purchase incumbent cable operators. But Congress and the FCC have reasonably concluded, after their "lengthy investigation of the relationship between the cable and [telephone] industries" (see *Turner*, 114 S. Ct. at 2475 (Stevens, J., concurring in part and concurring in the judgment)), that to permit LECs to do so would involve too great a risk of extending their telephone monopoly to the cable market. Their decision furthers the "basic tenet of national communications policy"—that "the

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of LECs' telephone monopolies into the cable market, and with the FCC's policy of promoting diversity in communications media by encouraging the development of video dialtone as another outlet for video speech. See *Video Dialtone Order*, 7 F.C.C. Rcd at 5783.

widest possible dissemination of information from diverse and antagonistic sources is essential to the welfare of the public." *Id.* at 2470 (opinion of the Court).

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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RULE 29.1 STATEMENT

Respondents hereby incorporate the Rule 29.1 statement in the Response to the Petitions for Certiorari.

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BRIEF FOR RESPONDENTS

STATEMENT OF THE CASE

This case concerns the constitutionality of a federal statute, 47 U.S.C. § 533(b), which prohibits local telephone companies from providing video programming directly to subscribers in their telephone service areas. Section 533(b)(1) forbids telephone companies from "provid[ing] video programming" *in any way* "directly to subscribers" — whether they create such programming from scratch or instead edit and arrange programs created by others into a "programming" package.[1] Section 533(b)(2) bans telephone companies from providing this programming using their own facilities.[2] Together, these provisions constitute a ban on the expressive process of providing video programming of one's choice — *i.e.*, a ban on the editorial process itself.

Every one of the 16 federal judges who has considered the question has concluded that § 533(b) is invalid under the First Amendment. Every one of the agencies with responsibility over federal telecommunications policy has recommended the elimination of § 533(b), on the ground that the statute positively disserves any governmental interest in protecting consumers and fostering competition. Each House of Congress has now voted to repeal

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[1] Section 533(b)(1) provides:

> It shall be unlawful for any common carrier, subject in whole or in part to title II of [the Communications] Act, to provide video programming directly to subscribers in its telephone service area, either directly or indirectly through an affiliate owned by, operated by, controlled by, or under common control with the common carrier.

[2] Section 533(b)(2) provides:

> It shall be unlawful for any common carrier, subject in whole or in part to title II of [the Communications] Act, to provide channels of communications or pole line conduit space, or other rental arrangements, to any entity which is directly or indirectly owned by, operated by, controlled by, or under common control with such common carrier, if such facilities or arrangements are to be used for, or in connection with, the provision of video programming directly to subscribers in the telephone service area of the common carrier.

§ 533(b). A ban on speech so thoroughly repudiated cannot survive any form of First Amendment scrutiny.

A. THE HISTORY OF SECTION 533(b)

1. Section 533(b) had its genesis in a restriction imposed on telephone companies by the Federal Communications Commission ("FCC") in 1970. At that time, cable television — known as CATV ("community antenna television") service — was in its infancy. CATV operators built large antennas in rural areas and other places unable to receive clear television signals over the air and then strung cables, often on telephone or electric utility poles, from each central antenna to the CATV customers. Pet. App. 57a.[3]

CATV operators generally did not create, package, or arrange video programming. "Essentially, a CATV system no more than enhance[d] the viewer's capacity to receive the broadcaster's signals." *Fortnightly Corp. v. United Artists Television, Inc.*, 392 U.S. 390, 399 (1968). Under these circumstances, the prevailing understanding was that restrictions on CATV service did not implicate the First Amendment at all. *Id.*; *see also Buckeye Cablevison, Inc. v. FCC*, 387 F.2d 220, 225 (D.C. Cir. 1967).

In 1970, the FCC issued regulations prohibiting telephone companies from providing CATV service to their local subscribers and from furnishing pole attachments, conduit space, or other facilities to themselves or any affiliated entity for purposes of providing such service.[4] The FCC feared that "the telephone

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[3] References to the decisions of the District Court and Court of Appeals, as reprinted in the Appendix to the Government's Petition for Certiorari, are styled "Pet. App. __a." References to the Federal Communications Commission's *Third Report and Order*, FCC 95-203 (May 16, 1995) are styled "Supp. Br. App. __a." References to the Joint Appendix in this Court are styled "JA __." References to the Joint Appendix in the Court of Appeals are styled "Ct. App. JA __." References to the Brief of the Federal Petitioners in No. 94-1893 are styled "Govt. Br. __." References to the Brief of Petitioner NCTA in No. 94-1900 are styled "NCTA Br. __."

[4] Final Report & Order, *Applications of Telephone Common Carriers for Section 214 Certificates*, 21 F.C.C. 2d 307 (1970) ("1970 FCC Order"), *codified at* 47 C.F.R. § 64.601 (1971).

companies had the potential to discriminate against independent CATV providers, in favor of telephone company affiliates, in granting access to telephone poles for attachment of the CATV cables." Pet. App. 59a (citing 1970 FCC Order at 324). The Commission was also concerned that telephone companies might "preempt the market" in the "new and emerging" field of CATV service before independent operators had an opportunity to deploy their networks. 1970 FCC Order at 324, 325. The Commission referred to pole and conduit access as "the potential seedbed of the controversy." *Id.* at 326. Acknowledging that it was "impossible to foresee" how the CATV industry would develop over the longer term, the FCC promised to reassess the matter in due course. *Id.* at 329.

2. Congress addressed the FCC's concern about telephone company control of poles by enacting the Federal Pole Attachment Act of 1978, codified at 47 U.S.C. § 224. The Act authorizes the FCC, together with state officials, to regulate the rates, terms, and conditions of pole access for cable companies. *Id.* at § 224(b)(1). Immediately after the Act's passage, the FCC established a mathematical formula for determining "just and reasonable" attachment rates, 47 C.F.R. § 1.1409(c), and mutually acceptable contracts were soon hammered out in every locality. Notice of Inquiry, *Telephone Company-Cable Television Cross-Ownership Rules*, 2 FCC Rcd 5092, 5093-5094 (1987); JA 174-75.

3. Section 533(b) was adopted as part of the Cable Communications Policy Act of 1984 (the "1984 Cable Act"), Pub. L. No. 98-549, 98 Stat. 2779 (codified at 47 U.S.C. § 521 *et seq.*), the principal purpose of which was to deregulate the cable industry. As the District Court observed, "[l]egislative materials relating to § 533(b) are sparse. No legislative findings of fact accompanied the provision." Pet. App. 61a. The most pertinent "reference to § 533(b) in the legislative history of the 1984 Cable Act is a passage in the House Committee Report, which indicates that the intent of the provision was 'to codify current FCC rules concerning the provision of video programming over cable systems by common carriers.'" *Id.* (quoting H.R. Rep. No. 934, 98th Cong., 2d Sess. 56 (1984)). The same Committee Report explained, however, that the bill was not intended to prevent telephone companies from

transporting the video speech of others, but only from providing speech of their own. H.R. Rep. No. 934 at 57.

B. THE ORIGINAL BASES FOR THE BAN HAVE BEEN ELIMINATED BY CHANGED CIRCUMSTANCES

1. Since 1970, the cable industry has grown from a marginal supplier of passive antenna service to "our Nation's dominant video distribution medium." S. Rep. No. 92, 102d Cong., 1st. Sess. 3 (1991). In 1970, "CATV reached only approximately 9% of all homes and mainly consisted of small, limited capacity systems in remote communities." Pet. App. 65a. Now, cable television is available to 98% of the nation's homes, and at least 60% of the television households subscribe. *U S West, Inc. v. United States*, 48 F.3d 1092, 1102 (9th Cir. 1994), *petition for cert. pending*, No. 95-315; *see also* JA 197, 198.

In the Cable Television Consumer Protection and Competition Act of 1992, 106 Stat. 1460 ("1992 Cable Act"), Congress documented the "undue market power" of cable operators which has resulted in "barriers to entry for new programmers and a reduction in the number of media voices available to consumers." §§ 2(a)(2), 2(a)(4), 106 Stat. 1460. *See generally Turner Broadcasting System, Inc. v. FCC*, 114 S. Ct. 2445, 2454-55 (1994). "Despite Congressional efforts to promote competition in the cable industry, the provision of cable television has remained a monopoly service in virtually every community." Pet. App. 66a. Fewer than 1% of cable markets are competitive. JA 199; *see also Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 9 FCC Rcd 7442, at ¶ 13 (Sept. 28, 1994) (*1994 Competition Report*).

2. Technology has also changed dramatically since § 533(b) was adopted. In 1984, it was not feasible for telephone companies to provide video programming over the basic telephone network. JA 138. Even as recently as 1991, a Senate committee report assumed that "telephone company networks are incapable of carrying video signals to the home." S. Rep. No. 92, 102d Cong., 1st Sess. 18 (1991). Today, however, telephone companies can provide video programming over the telephone network, JA 139-

40, offering many new channels of communication to compete with incumbent cable monopolists. As the District Court observed, § 533(b) now excludes "the one class of potential competitors that has exhibited an inclination to compete with the entrenched monopolists [and] clearly operates in the first instance to restrict competition in the market for video programming." Pet. App. 96a.

3. In addition, since 1984, regulators have developed an entirely new set of rules governing telephone company provision of services like video programming. These rules prohibit anti-competitive acts and thus directly target all of the interests identified by the Solicitor General. Both the FCC and the Department of Justice have repeatedly concluded that the rules are fully effective. "Whatever might have been possible prior to the break-up of the unified Bell System, or before we instituted a comprehensive package of regulatory safeguards, the reality today is that the FCC does have effective tools, and has clearly demonstrated both the willingness and ability to use them." JA 352-53 (FCC Chairman Sikes); *see also* JA 355 ("the Department [of Justice] disagrees with those commentators who argue that the [FCC's] rules are inadequate to protect against anticompetitive conduct").

4. These changed circumstances have led every expert telecommunications agency, during both Republican and Democratic Administrations, to conclude that § 533(b) affirmatively *disserves* the very purposes that the petitioners claim it substantially furthers, and that the ban should be eliminated.[5]

After compiling a full administrative record over five years, in 1992 the FCC formally recommended the removal of § 533(b) on the ground that such action would "increas[e] competition in the video marketplace, spur[] the investment necessary to deploy an advanced infrastructure, and increas[e] the diversity of services made available to the public."[6] According to the FCC, lifting § 533(b) "would result in significant price savings for consumers."

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[5] The agencies' conclusions are excerpted at JA 337-60.

[6] JA 337 (citation omitted); *see also* Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking, *Telephone Company-Cable Television Cross-Ownership Rules*, 7 FCC Rcd 5781, 5820 (1992) ("*Video Dialtone Order*").

JA 339-40. Reed E. Hundt, the current Chairman of the FCC, has testified that removing § 533(b) would foster "facilities-based competition," "expand the electronic marketplace of ideas," and result in "technological and service innovation, lower prices, and responsiveness to consumer tastes." JA 376-77.

In November 1994, the Commission reiterated its recommendation that § 533(b) be eliminated and explained that any residual anticompetitive risk "can and should instead be addressed through . . . appropriate regulatory safeguards."[7] In May 1995, the FCC released its *Third Report and Order*, Supp. Br. App. 1a-21a, which announced a dramatic reinterpretation of the Commission's "good cause" waiver policy, in light of the FCC's finding that "routinely" *waiving*, rather than *enforcing*, the ban would "promote competition." *Id.* at 9a-10a, 19a.

The Department of Justice has similarly concluded that telephone company "provision of video programming will have procompetitive benefits that outweigh any anticompetitive risks involved." JA 342 (citation omitted). In congressional testimony, Anne K. Bingaman, the current Assistant Attorney General, Antitrust Division, recently reaffirmed that telephone companies should be permitted to offer "both video and telephonic services in the same geographic areas." JA 381.

The National Telecommunications and Information Administration (NTIA), a unit of the Department of Commerce, has similarly determined that lifting § 533(b) "would significantly increase competition in the video services market, which would, in turn, yield lower prices to viewers, better service quality, and better programming diversity." JA 346. NTIA has also concluded that § 533(b) is "inefficient and anticompetitive" and that the risks it purports to address "are either overstated or can be effectively ameliorated by adapting existing regulatory safeguards to suit the video programming marketplace." NTIA, *The NTIA Infrastructure Report, Telecommunications in the Age of Information* 235, 242 (1991) ("NTIA Infrastructure Report"); *see also* JA 382, 383.

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[7] Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, *Telephone Company-Cable Television Cross-Ownership Rules*, 10 FCC Rcd 244 at ¶ 265 (1994).

In January 1994, the Administration released its "White Paper on Communications Act Reforms," which advocated removing § 533(b): "Although the existing cable-telephone company cross-ownership restriction of the 1984 Cable Act may have been appropriate when enacted, today it is an unnecessary and artificial barrier to competition in the delivery of video programming to American consumers and to investment in advanced local infrastructure." JA 370.

5. Each House of Congress has voted to repeal § 533(b): on June 16, 1995, the Senate passed S. 652 by a vote of 81-18, and on August 4, 1995, the House adopted H.R. 1555 by a vote of 303-117. Members of Congress explained that "[t]he cable television market will be made fully competitive as telephone companies are given the right to offer cable television services. . . . Consumers will see many new services, lower prices, and greater choices. The bill will also encourage new investments by telecommunications companies, building for our nation the much heralded national information infrastructure." 141 Cong. Rec. H 8459 (Aug. 4, 1995) (Rep. Boucher); *see also* 141 Cong. Rec. H 8281 (Aug. 2, 1995) (Rep. Bliley). Sen. Lott called § 533(b) "the equivalent of an 'Edsel' in the space and information age." 141 Cong. Rec. S 7906 (June 7, 1995). Sen. Kerrey stated that, in the absence of the ban, "'telephone companies might have offered cable service two decades ago and perhaps have prevented cable television monopolies in local markets.'" 141 Cong. Rec. S 8194 (June 12, 1995) (internal quotation omitted).

C. THE PROCEDURAL HISTORY OF THIS CASE

Bell Atlantic filed its complaint in December 1992. JA 6. After informal discovery, the factual issues were fully developed in a record of several thousand pages consisting of a comprehensive stipulation of facts, numerous undisputed affidavits, and extensive exhibits. As the District Court remarked, "it is difficult to imagine a more complete record." Pet. App. 57a. The parties filed cross-motions for summary judgment, with no party suggesting that there was any issue of material fact that would prevent the court from deciding the case on the existing record. Although the District

Court observed that § 533(b) cannot "be applied without reference to the content of the message being conveyed," *id.* at 85a, the court believed that the statute nonetheless qualified as "content-neutral" under this Court's decision in *City of Renton v. Playtime Theatres, Inc.*, 475 U.S. 41 (1986). However, the District Court held that § 533(b) was a "draconian approach" that "does not fit with its asserted justification," Pet. App. 99a, 102a, and thus could not survive intermediate scrutiny.

The Court of Appeals also found that § 533(b) was content-neutral. Pet. App. 28a. But the court held that § 533(b) failed intermediate scrutiny because it was not narrowly tailored to the Government's asserted interests and failed to leave telephone companies with sufficient alternative channels for communication. *Id.* at 38a-51a.

Subsequently, nine additional, separate lawsuits challenging § 533(b) were filed across the Nation. Every one of the other federal courts to consider the question has agreed that § 533(b) violates the First Amendment.[8] Not a single judge has dissented.

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[8] In addition to the decisions below, see *U S West, Inc. v. United States*, 855 F. Supp. 1184 (W.D. Wash.), *aff'd*, 48 F.3d 1092 (9th Cir. 1994), *petition for cert. pending*, No. 95-315, 64 U.S.L.W. 3160 (Aug. 23, 1995); *Pacific Telesis Group v. United States*, 48 F.3d 1106 (9th Cir. 1994), *petition for cert. pending*, No. 95-315, 64 U.S.L.W. 3160 (Aug. 23, 1995); *BellSouth Corp. v. United States*, 868 F. Supp. 1335 (N.D. Ala. 1994), *appeal pending*, No. 94-7036 (11th Cir.); *Ameritech Corp. v. United States*, 867 F. Supp. 721 (N.D. Ill. 1994), *appeal pending*, No. 95-1223 (7th Cir.); *NYNEX Corp. v. United States*, No. 93-323-P-C (D. Me.) (Dec. 20, 1994), *appeal pending*, No. 95-1183 (1st Cir.); *GTE South, Inc. v. United States*, No. 94-1588-A (E.D. Va. Jan. 13, 1995), *appeal pending*, No. 95-1738 (4th Cir.); *United States Telephone Ass'n v. United States*, No. 1:94CV01961 (D.D.C. Feb. 14, 1995), *appeal pending*, No. 95-1175 (D.C. Cir.); *Southwestern Bell Corp. v. United States*, No. 3:94-CV-0193-D (N.D. Tex. Mar. 27, 1995), *appeal pending*, No. 95-10478 (5th Cir.); *Southern New England Telephone Co. v. United States*, No. 3:94-CV-80 (D. Conn. Apr. 27, 1995), *appeal pending*, No.95-6137 (2d Cir.); *see also GTE California, Inc. v. FCC*, 39 F.3d 940, 951 (9th Cir. 1994) (Noonan, J., dissenting) (concluding, where majority did not reach merits, that § 533(b) is "counterproductive. . . . It does not even survive rationality review.").

SUMMARY OF ARGUMENT

I. Section 533(b) is properly subject to invalidation under strict scrutiny for at least two separate reasons. First, it is a direct ban on speech — the editorial process of selecting, assembling, and packaging programming for provision directly to subscribers — and nothing but speech. Thus, § 533(b) bans the very acts that this Court has identified as warranting First Amendment protection in the cable context. *See Turner*, 114 S. Ct. at 2456.

Section 533(b) flatly excludes telephone companies from what is indisputably the Nation's most important medium of communication. JA 152-57. Although reasonable time, place, and manner rules are permissible, "[a]dditional restrictions such as an absolute prohibition on a particular type of expression will be upheld only if narrowly drawn to accomplish a compelling governmental interest." *United States v. Grace*, 461 U.S. 171, 177 (1983). This Court has made clear that "prohibitions foreclosing entire media" — particularly "important and distinct" media of expression — are ordinarily impermissible even if they are "completely free of content or 'viewpoint discrimination.'" *City of Ladue v. Gilleo*, 114 S. Ct. 2038, 2045 (1994) (invalidating ordinance that banned residential signs).

In addition, § 533(b) is subject to strict scrutiny for the separate reason that it *is* content-based. Section 533(b) "requires reference to the content of the relevant message in order to determine whether a particular visual image qualifies under the statutory definition of video programming," Pet. App. 84a — *i.e.*, "programming provided by, or generally considered comparable to programming provided by, a television broadcast station." 47 U.S.C. § 522(19). "[B]y any commonsense understanding of the term, the ban in this case is 'content-based.'" *City of Cincinnati v. Discovery Network, Inc.*, 113 S. Ct. 1505, 1516-17 (1993). Indeed, the definition of "video programming" is so inherently subjective as to amount to a "know-it-when-we-see-it" standard. It vests an administrative agency, the FCC, with impermissibly broad power over speech.

II. Even if strict scrutiny did not apply, § 533(b) could not survive intermediate scrutiny because it is not narrowly tailored to any significant governmental interest. *Every* expert telecommunications agency has concluded that § 533(b) is affirmatively *anti-competitive*and that existing regulatory safeguards could be adapted to serve any governmental purpose supposedly fostered by § 533(b). It is thus impossible for the Government to meet its burden of "demonstrat[ing] that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way." *Turner*, 114 S. Ct. at 2470.

The Government contends that § 533(b) prevents telephone companies from attempting to increase their profits by improperly shifting costs from video programming activities to regulated telephone service. But the undisputed record is that there is no risk of cost shifting in the absence of common costs, and that there are no common costs between the provision of video programming and the operation of the telephone network. If the problem of potential cost misallocation exists at all, it exists with respect to video transport, *which § 533(b) does not prohibit*. Moreover, every expert telecommunications agency has determined that existing regulatory safeguards are fully adequate to address any danger of cross-subsidy. The FCC's response to any difficulties in applying these rules has been to err on the side of *overcompensating* against any cross-subsidy risk. Accordingly, even if the cross-subsidy concern were valid, § 533(b) prohibits far more speech than is necessary to achieve the Government's purposes.

The Government also asserts an interest in preventing telephone company discrimination against cable companies in providing access to poles and conduit. But regulators have long disregarded this as a serious concern because cable networks are already fully deployed and accessible to 98% of the television households in the United States. The Pole Attachment Act ensures fair and reasonable rates. If, for some reason, the Act is not entirely up to the task, it can be amended or new regulations can be promulgated.

In the end, the Solicitor General is forced to fall back to the hypothesis that Congress might have concluded that § 533(b) is needed as a prophylactic measure to avoid the complexities and inconveniences of more narrowly targeted regulation. But Congress has made *no* findings in support of § 533(b), either in 1984 or in

the ensuing years. The only formal actions taken have been the recent votes by each House to repeal § 533(b).

More fundamentally, the Government's entire argument is foreclosed by elementary principles of narrow tailoring. The Government is not entitled to silence speech for the sake of convenience or as added insurance supposedly to *guarantee* that its interests are met. *Edenfield v. Fane*, 113 S. Ct. 1792, 1802-04 (1993); *Schneider v. State of New Jersey*, 308 U.S. 147, 164-65 (1939). If the Government is concerned about discrimination, it can ban discrimination. If it is concerned about cross-subsidy, it can ban that. But in neither event may it simply ban speech.

In addition, § 533(b) fails intermediate scrutiny because it does not leave open adequate alternative avenues of expression. Section 533(b) has no more constitutional validity than a law prohibiting the *Washington Post* from publishing a newspaper but leaving it free to communicate through handbills, magazines, books, and billboards. Each of the Solicitor General's proffered alternatives is wholly inadequate. For example, he proposes that telephone companies might create programming and offer it to other, independent companies, such as local broadcasters or cable companies, who might or might not choose to distribute it to the public. But the denial of the telephone companies' editorial freedom can hardly be overcome by subjecting them to the editorial discretion of others.

III. The FCC's *Third Report and Order* cannot save § 533(b). That Order is nothing more than a statement of the FCC's unilateral intent, subject to change at any time in the Commission's discretion, to permit telephone companies to provide video programming under certain "terms and conditions" still to be devised by the Commission. Supp. Br. App. 6a n.11, 13a-14a. The *Third Report and Order* is in effect a promise voluntarily to cease the challenged conduct — a promise the FCC has twice breached by banning telephone companies from providing video programming over their networks despite outstanding federal court orders enjoining enforcement of the ban. The *Third Report and Order* provides no reason for this Court to refrain from holding § 533(b) unconstitutional.

Moreover, petitioners' "saving construction" is not a serious one. It contradicts the sole authoritative judicial interpretation of

§ 533(b)(4), as well as the prior determinations of the FCC. Furthermore, far from "saving" the statute, the construction would *exacerbate* the constitutional defect in § 533(b), by giving the Commission impermissibly broad licensing power over telephone company speech. And the construction would require this Court to decide the difficult constitutional question of whether telephone companies can be required to provide video programming exclusively through common carrier video transport systems, known as "video dialtone."

ARGUMENT

I. SECTION 533(b) IS INVALID UNDER STRICT SCRUTINY

Section 533(b) is subject to invalidation under strict scrutiny for at least two independent reasons.

A. SECTION 533(b) IS A DIRECT BAN ON SPEECH ITSELF, NOT A RESTRICTION ON CONDUCT, OR ON THE "TIME, PLACE OR MANNER" OF SPEECH

1. Section 533(b) bans telephone companies from providing, directly to their subscribers, video programming of the companies' own creation, selection, or arrangement. It "prohibits a common carrier from selecting or providing the video programming to be offered over a cable system" in the telephone company's service area. H.R. Rep. No. 934, 98th Cong., 2d Sess. 57 (1984). Certainly, therefore, § 533(b) bears no resemblance to a restriction on "conduct" that has merely an "incidental" effect on speech when applied to an expressive instance of that conduct. *United States v. O'Brien*, 391 U.S. 367, 376 (1968).

Rather, § 533(b) is a direct ban on speech and nothing but speech. As the District Court observed, "[t]he telephone company only runs afoul of the statute by exercising control or discretion over the programming transported . . . ." Pet. App. 102a; *see also id.* at 15a n.10 (§ 533(b) is a ban on "the provision, with editorial

control, of cable television services") (emphasis omitted). Section 533(b) targets the very acts of expression that this Court has identified as warranting First Amendment protection in the cable context. *See Turner*, 114 S. Ct. at 2456. Accordingly, § 533(b) is infirm for the same reason that the ban on editorial control over parades was unconstitutional in *Hurley v. Irish-American Gay, Lesbian and Bisexual Group of Boston*, 115 S. Ct. 2338 (1995). In fact, in *Hurley* this Court drew an explicit parallel to the very kind of editorial discretion that § 533(b) bans telephone companies from exercising. *See* 115 S. Ct. at 2345 ("Cable operators, for example, are engaged in protected speech activities even when they only select programming originally produced by others.").

Strict scrutiny is not limited to bans on speech that are based on the viewpoint, subject, or other "content" of the message being communicated. *See, e.g., Simon & Schuster v. New York Crime Victims Bd.*, 502 U.S. 105, 126 (1991) (Kennedy, J., concurring in judgment). Rather, strict scrutiny extends as well to bans like § 533(b) that tell speakers (especially a select *set* of speakers, *see City of Lakewood v. Plain Dealer Pub. Co.*, 486 U.S. 750, 763 (1988)), even in a content-neutral way, that they may not provide, at any time or place, speech to the audience and in the manner of their choosing. *See, e.g., Schad v. Borough of Mount Ephraim*, 452 U.S. 61, 75-76 (1981) (no live entertainment); *Buckley v. Valeo*, 424 U.S. 1, 15, 16, 17, 39, 44 (1976) (*per curiam*) (limits on political expenditures); *Martin v. City of Struthers*, 319 U.S. 141, 145-49 (1943) (limits on distributing literature door-to-door).

2. Section 533(b) is readily distinguishable from the cross-ownership rules cited by petitioners (Govt. Br. 3 n.2, 25 n.15; NCTA Br. 13 n.12, 46-48), for it is a ban on speech that does not even address the issue of ownership or control. "Cross-ownership" rules prevent an entity from owning two distinct media properties side by side. A TV broadcast station owning a newspaper in the same community is engaged in cross-ownership. *See* 47 C.F.R. § 73.3555(d) (1994). Section 533(b) does not prohibit telephone companies from constructing, buying, or *owning* cable systems *even within their own telephone service areas* — so long as an independent entity selects and arranges the video programming that

is provided to viewers.[9] In the District of Columbia, for example, Bell Atlantic owns the cable system and leases it to an unaffiliated company which provides the programming. JA 207-08.[10]

Section 533(b) is instead a rule that prohibits a speaker from using even its own facilities to provide speech of its own choosing. It would be, for example, as if the Manchester *Union Leader* were permitted physically to print and distribute newspapers, but banned from having its writers compose articles and its own editors select and arrange particular stories for publication.

3. This Court has consistently held that laws like § 533(b), which substantially foreclose an "important and distinct" medium of expression, cannot properly be characterized as "time, place, or manner" rules. *City of Ladue v. Gilleo*, 114 S. Ct. at 2045. Moreover, this Court has always distinguished between "a reasonable restriction on the manner" of speech and "a direct regulation of . . . speech itself." *Edenfield*, 113 S. Ct. at 1801. Section 533(b) plainly falls into the latter category. True time, place, and manner rules do not interfere with a speaker's ability to communicate the same speech to that speaker's chosen audience. *Ward v. Rock Against Racism, Inc.*, 491 U.S. 781, 802 (1989).

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[9] H.R. Rep. No. 934 at 57 (§ 533(b) does not "prevent a common carrier from constructing . . . a local distribution system that is capable of delivering video programming . . . [or] from leasing . . . such a system to a . . . cable operator"); *Video Dialtone Order*, 7 FCC Rcd at ¶ 111 (telephone companies are not barred "from acquiring existing cable facilities and leasing the physical plant to the franchised cable service provider").

[10] The cross-ownership rules cited by petitioners, together with *FCC v. National Citizens Comm. for Broadcasting*, 436 U.S. 775 (1978) ("*NCCB*"), are also inapposite because they relate to the specialized broadcast context governed by *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367 (1969), as this Court — and every lower court to consider § 533(b) — has recognized. *See Turner*, 114 S. Ct. at 2456-57; Pet. App. 21a-22a, 73a-74a; *U S West*, 48 F.3d at 1098; *BellSouth*, 868 F. Supp. at 1339; *Ameritech*, 867 F. Supp. at 729-31. *NCCB* reflects the power of government, in the "unique" medium of broadcasting, *Turner*, 114 S. Ct. at 2457; *Red Lion*, 395 U.S. at 367, to deny broadcast licenses to local newspapers. This special power has no application in this case. Indeed, *NCCB* explained that "the broadcast media pose unique and special problems not present in the traditional free speech case." 436 U.S. at 799 (internal quotations omitted).

The FCC has described § 533(b) as an "absolute ban" that "prohibits [telephone companies] from choosing the video programming to be provided in their local exchange telephone service areas *altogether*." Supp. Br. App. 3a, 4a (emphasis in original). Indeed, the practical effect of § 533(b) is to exclude telephone companies from what is indisputably "the most important mass medium in America." JA 142. The average television household watches television seven hours per day, whereas the average U.S. resident spends less than half an hour per day reading a newspaper. JA 196. The Government itself has recognized that the "'power to communicate ideas through sound and visual images . . . is significantly different from traditional avenues of communication because of the immediacy of the medium.'" *Telecommunications Research & Action Center v. FCC*, 801 F.2d 501, 508 (D.C. Cir. 1986) (quoting FCC), *cert. denied*, 482 U.S. 919 (1987).

Nor can § 533(b) be saved from strict scrutiny simply because it does not prohibit *every conceivable means* of communication potentially available to telephone companies. In *Ladue*, for example, this Court invalidated a law banning homeowners from posting signs even though it did not prevent them from "taking out a newspaper advertisement, handing out leaflets on the street . . ., standing in front of [a] house with a handheld sign," or even displaying flags with written messages. 114 S. Ct. at 2045, 2046 & n.16; *see also Lovell v. Griffin*, 303 U.S. 444, 451 (1938) (limit on distribution of literature is "no restriction . . . with respect to time or place"). Indeed, if § 533(b) could be deemed a "manner" restriction, then any ban on speech could be similarly described, so long as it left open some *possible* means of expression — whether soapbox oratory, purchase of a television station, or any of the other alternatives posited by petitioners in this case.

And § 533(b) is surely not a "place" restriction, despite its geographical reference, because it would permit telephone companies to provide video speech only in an entirely different region of the country — *i.e., to an entirely different audience*. "[O]ne is not to have the exercise of his liberty of expression in appropriate places abridged on the plea that it may be exercised in some other place." *Schneider*, 308 U.S. at 163 (ban on leafletting

in public streets invalid even though it left "persons free to distribute printed matter in other public places").

B. SECTION 533(b) IS CONTENT-BASED

1. Section 533(b) also triggers strict scrutiny for the independent reason that it is content-based. It prohibits telephone companies from providing their subscribers with "video programming," defined as "programming provided by, or generally considered comparable to programming provided by, a television broadcast station." 47 U.S.C. § 522(19). For example, a telephone company may offer stock market quotes, but not *Wall Street Week in Review*; on-line airline guides, but not a show about travel; educational multimedia presentations combining text, sound, and video, but not *Sesame Street*. *Video Dialtone Order*, 7 FCC Rcd at ¶¶ 76, 77 & n.196.

This statutory line has nothing to do with "the mode of delivery of the speech" (Govt. Br. 21) — in all of the examples, the speech would be delivered via the telephone network. Rather, the line is drawn according to the expressive attributes of the content of the speech: whether it is "generally considered comparable to programming provided by a television broadcast station" in 1984. *Video Dialtone Order*, 7 FCC Rcd at 5820; JA 363-64.

2. "[B]y any commonsense understanding of the term, the ban in this case is 'content-based.'" *Discovery Network*, 113 S. Ct. at 1513, 1516-17 (distinction between "commercial handbills" and "newspapers" is content-based, even though "[t]here is no doubt a 'common sense' basis for distinguishing between the two"); *see also Burson v. Freeman*, 504 U.S. 191, 207 (1992); *FCC v. League of Women Voters*, 468 U.S. 364, 383 (1984). Indeed, the Government concedes that a law distinguishing among "commercial or noncommercial, independent or network-affiliated, English or Spanish language" programming *would be* content-based. Govt. Br. 19 (quoting *Turner*, 114 S. Ct. at 2460). In no sense can a law singling out programming on the basis of whether it is "generally considered comparable to" 1984 television programming be deemed "content-neutral."

3. The Government's attempts to shield § 533(b) from strict scrutiny misconstrue settled First Amendment jurisprudence. For example, the Government insists that § 533(b) is not content-based because it supposedly "is not motivated by hostility to any message." Govt. Br. 20. But the motive of the legislature is irrelevant in determining the applicable level of scrutiny for a law that *by its very terms* discriminates on the basis of content. *Turner*, 114 S. Ct. at 2459 ("the mere assertion of a content-neutral purpose [will not] be enough to save a law which, on its face, discriminates based on content"). The Government suggests that § 533(b) should be less than strictly scrutinized because it is viewpoint-neutral. Govt. Br. 22. But it is axiomatic that viewpoint neutrality is not the same as content neutrality. *E.g.*, *McIntyre v. Ohio Elections Comm'n*, 115 S. Ct. 1511, 1518 (1995) (striking down a ban on anonymous leafletting that "applie[d] evenhandedly to advocates of differing viewpoints, [because it was] a direct regulation of the content of speech"); *Burson*, 504 U.S. at 197; *Arkansas Writers' Project, Inc. v. Ragland*, 481 U.S. 221, 229-30 (1987).

The Government also maintains that § 533(b) should be exempt from strict scrutiny because it can be *justified* without reference to the content of speech. But this Court has never indicated that a law which is content-based *on its face* can escape strict scrutiny because the Government's litigators can, with enough ingenuity, formulate a content-neutral rationale for it. If the contrary were true, almost any content-based law could avoid strict scrutiny.

4. Section 533(b) is also invalid because it vests an administrative agency with impermissible discretion over speech. The Government concedes that "instances may arise in which it will be difficult to determine whether a certain series of video images is 'comparable to' television broadcasting." Govt. Br. 22. The FCC has explained, for example, that interactive video programs "generally" fall outside § 533(b)'s prohibition, but "the mere inclusion of *some* interactive capability" would not take programming outside the ban. *Video Dialtone Order*, 7 FCC Rcd at 5821 & 5822 n.195 (emphasis added). In addition, according to the FCC, an "educational multimedia presentation which may contain video images" is not covered by § 533(b), but "the simple inclusion of *some* textual information" in a video program does not

make it a permissible multimedia presentation. *Id.* at 5822 n.196 (emphasis added). "[T]he Commission will allow telephone companies to transmit presentations that are *primarily textual*, and include *some* video segments, but will prohibit presentations that are *primarily video*, and include *some* textual segments." Pet. App. 87a (emphasis added).

It is not surprising that the Court of Appeals — even though it considered the statute content-neutral — nonetheless found this scheme constitutionally suspect. Pet. App. 29a n.22. The line between the permissible and the forbidden is far too subjective — like a statute leaving to an administrator the task of banning paintings "comparable" to those of Monet. The problem is not of the FCC's making; rather, the "know-it-when-we-see-it" quality of the *statutory definition* of video programming vests the FCC with the power and duty to "apprais[e] facts, . . . exercise . . . judgment, and . . . form[] an opinion," creating an intolerable "danger of censorship and abridgement of our precious First Amendment freedoms." *Forsyth County v. Nationalist Movement*, 112 S. Ct. 2395, 2401-02 (1992) (citations omitted); *see also City of Lakewood*, 486 U.S. at 757 ("the mere existence of the licensor's unfettered discretion, coupled with the power of prior restraint, intimidates parties into censoring their own speech, even if the discretion and power are never actually abused"); *Niemotko v. State of Maryland*, 340 U.S. 268, 272 (1951) ("custom" and "practice" insufficient restraint on discretion where "[n]o standards appear anywhere").

II. SECTION 533(b) CANNOT BE UPHELD EVEN UNDER "TIME, PLACE, OR MANNER" SCRUTINY

The Government contends that § 533(b) is a content-neutral "time, place, or manner" restriction that may be upheld under "intermediate scrutiny" so long as it (1) is "narrowly tailored to serve a significant governmental interest," and (2) "leave[s] open ample alternative channels for communication of the information," *Ward*, 491 U.S. at 791. But § 533(b) fails both prongs of this test. Its flat ban on video programming restricts far more speech than necessary to achieve any legitimate governmental interest, and none

of the alternative channels of communication that it leaves open is an adequate substitute for the video programming that it proscribes.

A. SECTION 533(b) IS NOT NARROWLY TAILORED TO SERVE A SIGNIFICANT GOVERNMENTAL INTEREST

Under the "narrow tailoring" requirement, the Government must demonstrate "that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way." *Turner*, 114 S. Ct. at 2470 (plurality opinion). Although a regulation need not be "the least speech-restrictive means" available, the Government must show that "the means chosen do not 'burden substantially more speech than is necessary to further the government's legitimate interests.'" *Id.* at 2469 (quoting *Ward*, 491 U.S. at 799).

That inquiry is particularly searching in the case of "preventative rules," like § 533(b), that impose "comprehensive bans" on entire categories of speech. *Edenfield*, 113 S. Ct. at 1802, 1803. As the Court has explained: "'Broad prophylactic rules in the area of free expression are suspect. Precision of regulation must be the touchstone in an area so closely touching our most precious freedoms.'" *Id.* at 1803-04 (quoting *NAACP v. Button*, 371 U.S. 415, 438 (1963)).

By its very nature, a prohibition on speech designed to prevent collateral harms — such as a ban on leafletting to prevent littering (*Schneider*, 308 U.S. 147), or a limitation on charitable fundraising to prevent *fraudulent* fundraising (*Village of Schaumburg v. Citizens for a Better Environment*, 444 U.S. 620 (1980)), or a ban on soliciting to prevent *unwanted* door-to-door soliciting (*Martin v. City of Struthers*, 319 U.S. 141 (1943)) — risks burdening First Amendment freedoms to a greater degree than necessary to achieve the Government's lawful purpose. Thus, "[i]f the government wants to avoid littering, it may ban littering, but it may not ban all leafleting. If the government wants to avoid fraudulent political fundraising, it may bar the fraud, but it may not in the process prohibit legitimate fundraising. If the government wants to protect householders from unwanted solicitors, it may enforce 'No

Soliciting' signs that the householders put up, but it may not cut off access to homes whose residents are willing to hear what the solicitors have to say." *Turner*, 114 S. Ct. at 2479 (O'Connor, J., concurring in part and dissenting in part) (internal quotations and citations omitted).

Section 533(b) suffers from the same constitutional infirmity. It bans video programming by telephone companies, not because much (or, indeed, *any*) of the speech thereby proscribed is itself harmful or undeserving of First Amendment protection, but assertedly because allowing a telephone company to provide such speech will encourage it to engage in anticompetitive "cross-subsidization" and "discrimination" to the detriment of telephone and cable consumers.

As we explain below, however, the Solicitor General has utterly failed to justify this sweeping prophylactic rule. The anticompetitive harms that he hypothesizes are rooted impermissibly in speculation and conjecture, not in the hard evidence that this Court's precedents require. The hard evidence is that 25 years of excluding telephone companies from providing video programming have produced cable monopolies in 99 percent of markets nationwide. Accordingly, every relevant governmental agency has concluded that the ban actually *disserves* the Government's purported objectives. But even if that threshold hurdle could be surmounted, the Solicitor General has not come close to justifying a flat ban on speech itself in preference to a direct ban on the feared anticompetitive conduct.

The most that the Solicitor General can say is that outlawing video programming is a "simpler" way to achieve the Government's objectives. Govt. Br. 31. But the Government can *always* say that. On the Solicitor General's theory, "comprehensive bans" on speech "would be permitted as a matter of course," *Edenfield*, 113 S. Ct. at 1803, a result altogether out of harmony with this Court's First Amendment precedents. It is no doubt "simpler" to outlaw leafletting than to enforce a law against littering, and more efficient to bar all household soliciting than to enforce a law prohibiting unwanted soliciting. But this Court repeatedly has ruled "simply and emphatically that the First Amendment does not permit the State to sacrifice speech for

efficiency." *Riley v. National Fed'n of the Blind*, 487 U.S. 781, 795 (1988) (citing *Schneider*, 308 U.S. at 147 and *Schaumburg*, 444 U.S. at 620). That principle is fatal to § 533(b).

1. The Government's Interest in Preventing Cross-Subsidy Cannot Justify a Ban on Video Programming

The Solicitor General argues that § 533(b) furthers the Government's "significant" interest in preventing "cross-subsidy." If telephone companies were free to provide video programming within their telephone service areas, the argument goes, they "would have an incentive to allocate the costs of their cable services to their monopoly telephone operations, and to have regulators set higher telephone rates based on those shifted costs." Govt. Br. 3. Having thus fooled the regulators, telephone companies could then effectively "subsidize their affiliated cable entities with monopoly telephone profits," thereby unduly burdening telephone ratepayers and subjecting cable competitors to unfair competition, all to the detriment of consumers. *Id.*

It is important to understand what "cross-subsidy" means in this context. A cross-subsidy can occur only if a cost-plus, rate-of-return regulated company is able to increase the profits from its regulated business by misallocating costs from an unregulated, competitive business to its regulated business. When cost-plus recovery is guaranteed, the more costs the better. Such a scheme can occur, however, only when there are costs in common between the regulated and unregulated businesses that can be shifted.

Given this background, the Solicitor General's effort to square § 533(b) with this regulatory concern is riddled with logical flaws.

a. The first problem with the Solicitor General's cross-subsidy theory is that § 533(b) is simply irrelevant to this regulatory issue. The statute does not ban the improper allocation of costs from unregulated to regulated services. It does not even address an activity that has common costs with telephone service. As both courts below properly found, Pet. App. 42a-43a, 101a-102a, what § 533(b) actually bans — the provision, with editorial control, of video programming by telephone companies — has *no* common

costs with telephone service. JA 274-75.[11] Conversely, § 533(b) leaves telephone companies entirely free to *transport* video signals generated and arranged by others, a service that *does* have common costs with telephone service.[12]

There is thus a complete mismatch between § 533(b) and the Government's supposed interest in preventing cross-subsidy. It is as if the State in *Schneider* had sought to prevent litter, not by banning littering, or even by banning the distribution of readily disposable leaflets, but by banning instead the distribution of any leaflets *containing the distributor's own message*. Just as the identity of a leaflet's author has nothing to do with the risk of litter, the identity of the video programmer whose signals are transmitted over a telephone company's facilitites has no link to any risk of cross-subsidy.

b. Petitioners speculate that a ban on video programming "removes the incentive" for telephone companies to engage in improper cost-shifting. Govt. Br. 25. According to petitioners, telephone companies already have the *power* to "cross-subsidize their video transport facilities," but their *incentive* to do so "would be greatly enhanced" if they were allowed to provide video programming, because that "would increase the value to the phone company of monopolizing transport." *Id.* at 26-27 (internal quotations omitted).

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[11] NCTA's own expert concedes that there are no common costs between telephone service and anything that § 533(b) actually prohibits. *See* JA 243. Thus, as NCTA has acknowledged, "opportunities for cross-subsidization may be few in the creation of programming." NCTA Mem. at 23, *United States v. Western Elec. Co.* (D.D.C. filed Oct. 17, 1990).

[12] It was stipulated below that, as a result of rapidly advancing technology, telephone companies (as well as cable companies) increasingly can transmit voice, data, and video signals over common network facilities. JA 195-96, 201-02; *see also* JA 138-41. "This kind of joint or common use is not an evil in itself: on the contrary, it is a source of efficiency — a clear exemplification of what economists refer to as economies of scope." JA 273 (affidavit of Prof. Alfred E. Kahn). Even under traditional rate-of-return regulation, the resulting economies will *benefit*, not harm, telephone ratepayers, so long as any joint costs of a common facility are allocated to video services.

As a threshold matter, petitioners' convoluted speculation about incentives is precisely the kind of "conjectural harm" that this Court rejected in *Turner*, 114 S. Ct. at 2470. As the Court of Appeals observed, "the FCC's contemporaneous discussions of its rule do not even hint at the complex of incentives and evils . . . involving the cable transport and video programming markets." Pet. App. 47a.

Even taken on its own terms, petitioners' argument is wrong. First, the goal of the cross-subsidizing firm is to increase its profits. If telephone companies actually could cross-subsidize video transport service without sacrificing overall profits, they would be doing that *now*. Money is money. Whether video programming is *more* profitable than video transport is beside the point, for the opportunities (if any) for cross-subsidy are limited to the joint costs associated with video transport.

The petitioners find themselves tripping over one another on this point. The Government asserts that, absent the ability to provide programming, a telephone company "has no incentive to drive cable companies out of business." Govt. Br. 27 (internal quotes omitted). But NCTA argues that "telephone companies have a uniquely strong incentive" to do so *now* because of "the competitive threat that cable presents to the telephone business itself." NCTA Br. 9, 37 & n.31; *see also* JA 187-88.

Second, there is a further mismatch between § 533(b) and the Government's "incentive" argument: the statute is not, despite the Government's claims, a ban on telephone companies' "earning profits" (Govt. Br. 26) from cable television. In fact, § 533(b) *allows* a telephone company to construct or purchase a cable system, arrange for a third party to choose the programming the system will offer, and share in the profits of that cable system — through rental income, for example, or through a direct 5% ownership in the third party operator. 47 C.F.R. § 63.54(e). A telephone company in such circumstances has a strong financial interest in the continued profitability of the cable system, despite its inability to select the programming. Even if it held no ownership stake in the cable operator, and even if rent were not computed directly on the basis of the cable system's profits, the telephone company would understand that the more valuable the property, the

higher the rent it could charge. A telephone company need not be involved in the direct provision of video programming at all: It could simply charge unaffiliated video programmers monopoly rates for carriage. Pet. App. 44a n.30.

c. Petitioners' arguments about cross-subsidy rest on the further erroneous supposition that regulators would be powerless to *prevent* telephone companies from improperly shifting to their regulated telephone services the costs of their competitive video services. But the FCC already "has in place a comprehensive system of cost allocation rules and cost accounting safeguards designed to separate nonregulated service costs from regulated service costs." *Video Dialtone Order*, 7 FCC Rcd at ¶ 92.[13] The FCC's response to the assertedly "complex" task of allocating joint costs (Govt. Br. 31) has been to *overcompensate* by assigning to a telephone company's *non*regulated activities a share of common costs substantially in excess of the incremental costs of those services.[14] And the Commission has "recently strengthened these cost accounting safeguards in order to ensure that the Commission is able to prevent and detect abuses should they occur. . . . Based on [its] experience with such safeguards, [the FCC] continue[s] to believe that they constitute an effective means of preventing cross-subsidization between regulated and unregulated services." *Video Dialtone Order*, 7 FCC Rcd at ¶ 92.

Every other telecommunications agency agrees with the FCC. The NTIA has concluded that the FCC's rules "are extensive and effective in controlling cross-subsidy." *NTIA Infrastructure Report*

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[13] These rules (1) impose detailed cost allocation standards, (2) establish accounting procedures, audit requirements, and other implementation and enforcement mechanisms, (3) require carriers (with operating revenues in excess of $100 million) to obtain FCC approval of a detailed cost allocation manual, and (4) set rules for recording transactions between regulated telephone companies and their corporate affiliates. *See* Report and Order, *Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities*, 2 FCC Rcd 1298, 1299 & n.70 (1987).

[14] "Far from permitting cross-subsidization of competitive by monopoly services, regulators have typically handicapped telephone companies in the competitive markets — inefficiently so." JA 278.

at 23. The Department of Justice has determined that FCC rules should be sufficient protection against cross-subsidy. Ct. App. JA 2767. The courts have also repeatedly upheld the FCC's accounting safeguards as "reasonably designed" to prevent cross-subsidization. *Southwestern Bell Corp. v. FCC*, 896 F.2d 1378, 1379 (D.C. Cir. 1990); *see also United States v. Western Elec. Co.*, 993 F.2d 1572, 1580-81 (D.C. Cir.) ("the FCC has acted since the break-up to tighten its accounting rules, especially its treatment of joint costs"), *cert. denied*, 114 S. Ct. 487 (1993); *California v. FCC*, 39 F.3d 919, 926 (9th Cir. 1994) ("[W]ith the implementation of these measures, the FCC has demonstrated that the [telephone companies'] incentive and ability to cross-subsidize will be significantly reduced"), *cert. denied*, 115 S. Ct. 1427 (1995); *U S West*, 48 F.3d at 1105-06; *American Scholastic TV Programming Found. v. FCC*, 46 F.3d 1173, 1182 & n.8 (D.C. Cir. 1995); *BellSouth*, 868 F. Supp. at 1342-43; *Ameritech*, 867 F. Supp. at 734-36.[15]

d. The regulatory premises of petitioners' cross-subsidy argument are flawed for yet another reason. As petitioners admit, cross-subsidy is a theoretical danger only to the extent that a telephone company is subject to traditional cost-plus rate-of-return regulation, under which carriers are allowed to recoup their costs of providing service plus a reasonable return on investment. Govt. Br. 3, 26, 35; NCTA Br. 5, 8, 11 & n.9, 37 n.31, 38 n.35, 42 n.37. But the FCC and a majority of the States now regulate the rates of the largest telephone companies under "price cap" rules that break the traditional link between costs and rates. *See National Rural Telecom Ass'n v. FCC*, 988 F.2d 174, 178 (D.C. Cir. 1993). "Under price caps, a [telephone company's] rates are governed by factors outside of its control, such as the inflation index, rather than by direct costs. Thus, a [telephone company] would have little incentive to shift costs from nonregulated activities to regulated ones because it would not be able to increase regulated rates to

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[15] That regulators may still occasionally "find evidence of cost-shifting" (Govt. Br. 34 n.24) proves only that the existing rules are vigorously enforced, not that they are ineffective.

recapture those costs." *California v. FCC*, 39 F.3d at 926; *see also Western Electric Co.*, 993 F.2d at 1580.

As the FCC itself only recently reiterated, "our price cap rules prevent telephone companies from raising interstate telephone service rates to recover nonregulated cable television investments."[16] The Department of Justice likewise has acknowledged that, under price caps, "[a] regulated firm would be unable to evade constraints through cross-subsidization. . . ." Ct. App. JA 1748. And NCTA's own expert has admitted that a pure price cap arrangement that severs the relationship between rates and costs would "reduce or eliminate the incentive to shift costs to regulated services. . . ." JA 263.[17] The mere availability of such obvious less burdensome measures to satisfy the Government's interests demonstrates that the restriction on speech is not narrowly tailored — even if those measures have not yet been adopted. *E.g.*, *Rubin v. Coors Brewing Co.*, 115 S. Ct. 1585, 1593-94 (1995); *Discovery Network*, 113 S. Ct. at 1510 & n.13.

The alternative of price cap regulation also shows that any risk of cross-subsidy here would stem *not* from a telephone company's

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[16] Fourth Report and Order, ¶ 18, *Telephone Company-Cable Television Cross-Ownership Rules*, CC Dkt. No. 87-266, FCC 95-357 (Aug. 14, 1995). *See also* JA 350-51 (FCC Memorandum); *Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards*, 6 FCC Rcd 7571, 7577-78 (1991) ("the adoption of price cap regulation . . . constitutes an effective complement to cost allocation, reporting, and enforcement safeguards, to reduce . . . incentives to cross-subsidize"), *aff'd in relevant part and rev'd in part*, 39 F.3d 919 (9th Cir. 1994).

[17] In this Court, too, the NCTA concedes that if "pure" price caps were widely adopted § 533(b) would be "substantially overbroad." NCTA Br. 37 n.31. In fact, the FCC, in new price cap rules adopted in April 1995, gave telephone companies the option to select precisely such a "pure" price cap mechanism for interstate services. First Report and Order, ¶¶ 19, 220, *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, FCC 95-132 (Apr. 7, 1995). Most of the companies subject to price caps have chosen that option. Fourth Further Notice of Proposed Rulemaking, ¶ 8, *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, FCC 95-406 (Sept. 27, 1995). Over 15 States, including many of the largest such as Michigan, Illinois, Pennsylvania, Virginia, and Wisconsin, have adopted pure price caps for intrastate services.

entry into competitive services but from a regulator's decision to choose rate-of-return regulation rather than price caps.[18] It would be wholly antithetical to the First Amendment to allow the Government to justify a ban on speech as needed to protect against regulatory risks of its own creation.

2. The Government's Interest in Preventing Anticompetitive Discrimination Cannot Justify a Ban on Video Programming

a. The Solicitor General argues that § 533(b) "is necessary to prevent [telephone companies] from abusing their control over the poles and conduits essential to the operation of a cable system (as the FCC concluded in 1970)." Govt. Br. 35. In 1970, however, cable television service was accessible to fewer than 10% of all households, and there was no legislation governing rates for pole and conduit access. The FCC believed that the then-nascent cable industry would be jeopardized if telephone companies were free to enter that business. *See* Govt. Br. 5.

That concern has no current vitality. In the Pole Attachment Act of 1978, Congress authorized the FCC, together with state officials, to "regulate the rates, terms, and conditions for pole attachments." 47 U.S.C. § 224(b)(1). Cable industry representatives themselves testified, even then, "that *access* to utility poles does not in itself constitute a problem." S. Rep. No. 580, 95th Cong., 2d Sess. 16 (1978) (emphasis added). The FCC staff likewise concluded as long ago as 1981 that "[t]he problem of pole access does not by itself justify banning crossownership." JA 62. The cable industry has since matured into an entrenched monopoly

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[18] *See, e.g.*, JA 56 (FCC Staff Report) ("This rationale for a crossownership ban is dependent on the assumption [of] rate of return regulation . . . . If regulators ignore reported costs and set rates on other grounds . . . the incentive to shift costs would likewise vanish"); *id.* at 72, 76 (FCC Staff Report) ("Many problems of telephone behavior are caused by rate-of-return regulation . . . . [R]ate regulation gives telephone companies strong incentives to engage in cost-shifting."); *id.* at 278 (Reply Aff. of Alfred E. Kahn) ("the cross-subsidization [petitioners] predict is possible only to the extent a telephone company's services are subject to cost-based, rate-of-return regulation").

to which "some ninety-eight percent of American homes have access." *U S West*, 48 F.3d at 1102. And the FCC accordingly has concluded that the "necessary access to poles and conduit to permit the growth of the cable industry has generally occurred." *Notice of Proposed Rulemaking*, 3 FCC Rcd at 5854; *see also* NTIA Infrastructure Report at 233.

Even if there were some residual concern about the cable industry's access to poles and conduit, that certainly could not justify § 533(b). As the District Court correctly noted, Pet. App. 102a n.29, "there is no doubt" that the law could be strengthened to guarantee non-discriminatory access, either by legislation,[19] or by FCC regulation,[20] as the Department of Justice has in fact proposed (Ct. App. JA 548), without any suppression of speech.

b. The Solicitor General also argues that § 533(b) eliminates any incentive for telephone companies to discriminate against competing video programmers who want to provide their programming via the yet-to-be-upgraded telephone network. Govt. Br. 5, 36-37. But telephone companies do not control any essential facility that these programmers need. *Cable companies*, which have deployed their own completely separate transmission networks and are not dependent on the telephone network for delivering their programming to customers, currently monopolize delivery of all multichannel video programming. Telephone company provision of video programming would greatly *expand*, not reduce, opportunities for independent programmers to reach their audiences.[21] It is perverse for the Government to cite a hypothetical

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[19] *E.g.*, H.R. 1555, 104th Cong., 1st Sess. §§ 242(a)(6), 244(b)(6) (1995); S. 652, 104th Cong., 1st Sess. § 251(b)(5) (1995); S. 1200, 102d Cong., 1st Sess. § 656 (1991) (Ct. App. JA 3109); H.R. 2546, 102d Cong., 1st Sess. § 656 (1991) (Ct. App. JA 3343).

[20] *See* Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, *Telephone Company-Cable Television Cross-Ownership Rules*, 10 FCC Rcd 244, at ¶ 285 (proposing rule "to prevent LECs from denying cable systems reasonable access to their pole or conduit space for the purpose of preventing competition from these cable systems").

[21] *See, e.g.*, JA 342 (Department of Justice) (lifting ban "will create an alternative player with whom third parties can bargain to carry their

potential for abuse against unaffiliated programmers as a justification for § 533(b), when lifting the ban would give these very programmers a voice that cable incumbents have denied to them.[22]

3. Section 533(b) Cannot Be Justified on the Basis of the Government's Preference for Administrative Convenience or Its Version of Regulatory History

The Government argues that, even if it would be "*possible* to prevent" cross-subsidy and discrimination through regulatory safeguards that do not interfere with expression, Congress was entitled to choose the "simpler" approach of outlawing speech in order to avoid the "administrative" inconvenience of narrowly targeted measures. Govt. Br. 31, 37 (emphasis in original). But, under either intermediate *or* strict scrutiny, considerations of ease and efficiency cannot justify a comprehensive ban on speech. *Edenfield*, 113 S. Ct. at 1802-04; *Riley*, 487 U.S. at 795. When the Government anticipates harmful effects supposedly associated with speech, the "simpler" way to guard against those harms will *always* be a complete ban on the speech.

The Government insists that Congress at least had "substantial evidence" on which to base its "choice of a simpler" ban on speech in preference to more precisely targeted regulatory solutions. Govt. Br. 31, 32. But even if this were relevant, the three items to which the Government points — the history of the AT&T divestiture, a

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programming"); JA 324 (Affidavit of Robin Smith) ("independent producers . . . need and would welcome the development of new distribution channels and new program packagers").

[22] Even with respect to voice and data information services conveyed exclusively over the phone network, the Government has documented at length that "there is no substantial risk that a [telephone company] could impede competition through discrimination" against competing content providers. Ct. App. JA 2631, 2635; *see also* Ct. App. JA 2772 ("existing regulation effectively constrains [telephone company] discrimination"). The FCC has similarly found that existing regulations will "address any concerns . . . with respect to discriminatory access." Ct. App. JA 2627 (FCC Mem. as *Amicus Curiae, United States v. Western Electric Co., Inc.*, C.A. No. 82-0192, at 11 (D.D.C. filed Aug. 22, 1990)).

1981 FCC Staff Report, and two reports from the General Accounting Office — could not support the surmise that regulatory safeguards "have significant disadvantages." Govt. Br. 31.

First, although petitioners cite the AT&T divestiture some 29 times in their briefs, it actually proves the opposite of what they claim. As part of the 1982 consent decree that broke up the Bell System and spawned the seven independent Regional Bell Operating Companies,[23] the parties voluntarily agreed to include a prohibition on telephone company provision of "information services," including cable television and database services like LEXIS/NEXIS. "[T]here really was no record to speak of concerning AT&T's activities in the information services market. The parties agreed to the information services restriction as a precautionary measure in light of uncertainty about how the divestiture of AT&T would affect development of this embryonic market." *United States v. Western Electric Co.*, 900 F.2d 283, 307-08 (D.C. Cir.) (*per curiam*), *cert. denied*, 498 U.S. 911 (1990). The Government itself said a "nonconsensual ban" on such services "would raise serious First Amendment issues." Ct. App. JA 1936 n.175; Ct. App. JA 2917 n.273.

If the Government's professed concerns about anticompetitive risk in video programming had any force, they would apply *a fortiori* to voice and data information services, which are often conveyed exclusively via local telephone exchanges over which telephone companies supposedly exercise "bottleneck" control. Yet in 1987, the Government asked the decree court to *eliminate* the information services restriction, concluding that there was "no substantial possibility that a [Bell Company] could . . . impede competition," Ct. App. JA 1906, 1909, and "no factual basis for" objections that telephone companies "would engage in cross-subsidization." Ct. App. JA 2790. In its decision affirming the decree modification, the D.C. Circuit endorsed the Government's determinations (1) "that there was no substantial risk that removal of the [information services] ban would lessen competition"; (2)

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[23] *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd mem. sub nom. Maryland v. United States*, 460 U.S. 1001 (1983).

that "regulation would play a substantial role in minimizing any anticompetitive risks"; and (3) "that removal of the ban would benefit consumers by enhancing competition in information services." *United States v. Western Electric Co.*, 993 F.2d at 1578. In fact, the court found that the evidence supporting the Government's request was so strong "that any district court rejection of the proposed modification would have been reversible error," and any findings that "contradict[ed] the Department's conclusions [would have been] clearly erroneous." *Id.*

Second, petitioners rely heavily (Govt. Br. 7, 26, 31-32, 35, 36; NCTA Br. 8-9, 38, 42, 43) on a November 1981 staff report, *FCC Policy on Cable Ownership* (*"Staff Report"*) (reprinted at JA 31-78). But they exaggerate the report's conclusions. The report acknowledged the significant pro-competitive benefits of telephone company provision of cable service. JA 43-52. But it concluded that the cable service ban should "be retained for the time being," JA 42, because the Commission's regulatory apparatus was still undeveloped: no "mechanism currently exists to separate cable costs from telephone costs." JA 58. The staff also noted that "further development of competitive technology" may render the restriction "unnecessary." JA 64.[24]

Changes in technology, market conditions, and regulation have made the Staff Report's recommendation obsolete. In particular, the report pre-dated the FCC's development of its cost-allocation regulations. In 1988, the Commission itself expressly rejected any prior reliance on cross-subsidy concerns as having occurred before the Commission "devised accounting standards that would prevent cross-subsidization." Further Notice of Inquiry and Notice of Proposed Rulemaking, *Telephone Company-Cable Television Cross-Ownership Rules*, 3 FCC Rcd 5849, 5854 (1988). Not surprisingly, the conclusions of the Staff Report have subsequently

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[24] The Staff Report did not represent the Commission's official views. In fact, the only Commissioner to comment on the issue filed a separate statement decrying what he called the "regulatory insanity" of not permitting telephone companies to enter cable television markets immediately. JA 27-29. He described the justifications for the ban as "sheer fantasy" and the predictions of anticompetitive harm as "border[ing] on hallucination." *Id.* at 27.

been repudiated by the FCC, the Department of Justice, the NTIA, and every reviewing court to consider the issue.

Third, petitioners claim that two reports issued by the GAO confirm the danger of cross-subsidy when telephone companies provide competitive services. But the GAO concluded not that § 533(b) — or any restriction on telephone company activities — should be retained but merely that FCC audit staff levels should be increased and that more on-site audits should be conducted.[25] And the FCC has since addressed this concern by requiring telephone companies to hire independent auditors to conduct annual audits.[26] Thus, the GAO reports confirm, rather than refute, the efficacy of regulatory mechanisms substantially less speech-restrictive than the prohibition imposed by § 533(b).

4. No "Deference to Congress" Is Warranted

The Government admits that Congress made no relevant factual findings in adopting § 533(b). Govt. Br. 29. But the Government's brief is nonetheless littered with suppositions about what "Congress reasonably concluded," *id.* at 31, and the Government suggests that Congress has somehow made a "predictive judgment" about the value of § 533(b) "to which the courts owe substantial deference." *Id.* 32 n.21. This argument is untenable.

In *Turner Broadcasting Co.*, a plurality of this Court emphasized that, even when Congress makes "unusually detailed" factual findings that "are recited in the text of the Act itself," 114 S. Ct. at 2454, 2461, in a First Amendment case a reviewing court is obligated to exercise "independent judgment" to ensure that the

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[25] *See* JA 86 ("GAO recommends that FCC develop a strategy for providing greater oversight of telephone companies' cost allocations. The key to the strategy is FCC's commitment to allocate sufficient audit staffing and travel funds to permit added field audits."); JA 134 ("expanded coverage through additional on-site audits by FCC would give ratepayers and the Congress greater assurance that cross-subsidization is not occurring").

[26] *See Computer III Remand Proceedings*, 6 FCC Rcd 7571, 7582. The GAO has admitted that these independent audits "should help." JA 85.

Government has met its burden of justification under intermediate scrutiny. *Id.* at 2471. This case is a step removed from that context.

Here, Congress has never made *any* findings that § 533(b) is necessary to address the specific interests identified by the Solicitor General. In fact, the only evidence cited of the supposed "predictive judgment" made by Congress is taken from snippets of legislative history that *post-date* passage of the ban. For example, the Solicitor General points to a 1990 Senate Commerce Committee report stating that the Committee "'could not at the present time'" support repeal of § 533(b) but adding (in a passage that he does not quote, *see* Govt. Br. 34) that "[t]he Committee wants the expert agency, the FCC, to examine the question." S. Rep. No. 456, 101st Cong., 2d Sess. 9 (1990). The FCC undertook such an examination, concluded that § 533(b) impedes competition, and recommended that it be removed. And in recent months each House of Congress has overwhelmingly voted to *repeal* the ban on video programming, signalling profound disagreement with the very rationale advanced by the Solicitor General and the cable incumbents before this Court.

Petitioners also suggest that, in adopting the 1992 Cable Act, Congress made a deliberate decision not to lift § 533(b). But the very Senate report they cite reveals otherwise: "the [Commerce] Committee decided that the question of whether telephone companies should be permitted to play a greater role in the cable market should be considered separately [from the question of whether to re-regulate cable]. . . . The Committee will [continue] to examine these issues." S. Rep. No. 92, 102d Cong., 1st Sess. 18 (1991). Indeed, the available evidence suggests that the Committee mistakenly believed that telephone networks would not soon be technologically capable of transmitting video programming. *See* pp. 4-5, *supra*.

In short, there are no congressional "findings" to which this Court could defer. By contrast, every expert governmental agency has explained in painstaking detail that each of petitioners' claims is wrong, in analyses that the Solicitor General has elsewhere argued are "particularly appropriate to respect." Br. of Govt.

Respondents in *Turner*, No. 93-44 at 30 (urging deference to the FCC's "predictive judgment").

B. SECTION 533(b) IS INDEPENDENTLY INVALID BECAUSE IT FAILS TO LEAVE OPEN ADEQUATE ALTERNATIVE AVENUES OF COMMUNICATION

Section 533(b) cannot be viewed as a mere limitation on the "manner" of speech. *See* Part I-A, *supra*. But even if the statute did not foreclose an entire medium, it would still fail intermediate scrutiny because it does not leave telephone companies with adequate alternatives for delivering their video speech. *See Members of City Council v. Taxpayers for Vincent*, 466 U.S. 789, 812 (1984). The Court of Appeals properly invalidated § 533(b) on this independent ground. Pet. App. 49a-51a.

1. "The First Amendment protects [speakers'] right not only to advocate their cause but also to select what they believe to be the most effective means for doing so." *Meyer v. Grant*, 486 U.S. 414, 424 (1988). For example, in *Edenfield*, this Court invalidated under intermediate scrutiny a ban on in-person solicitation by accountants even though it allowed them to solicit by mail or advertisement. 113 S. Ct. at 1799-1801.[27] Here, petitioners' proffered alternatives are no more adequate as a substitute for direct provision of video programming over the telephone network than the opportunity to distribute handbills is an adequate alternative for operating the *New York Times*.

2. Petitioners nonetheless claim that § 533(b) leaves open other means for telephone companies to engage in video speech (Govt. Br. 23-24, 37-38), but their proffered alternatives fall into three flawed categories. First, petitioners argue that telephone companies could *create* programming and offer it to television

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[27] *See also International Soc'y for Krishna Consciousness v. Lee*, 112 S. Ct. 2711, 2723 (1992) (Kennedy, J., concurring in the judgment) ("the Port Authority's regulation allows no practical means for advocates and organizations to sell literature within . . . its airports"); *id.* at 2727 (Souter, J., concurring in the judgment in relevant part) ("A distribution of preaddressed envelopes is unlikely to be much of an alternative.").

stations, cable operators, and others, who would decide whether, when, and how it would be *shown*. This would leave telephone company speech subject to the editorial control of others, and is thus no alternative at all, any more than writing letters to the editor is an alternative for publishing a newspaper.

Second, petitioners claim that telephone companies could bid to buy one of the few broadcast stations in each local market, or compete with other speakers to lease one or two channels that might be available on some local cable systems under the leased access provisions of 47 U.S.C. § 532. *See* JA 284-85. But each of these alternatives would severely constrain the amount of speech telephone companies could deliver.[28] Absent § 533(b), telephone companies could provide not one or two channels of video programming, but hundreds or thousands. JA 169; Description of Broadband Technologies' FLX System at 1 (Oct. 1992) (attached to Def. Supp. Jt. App. Exh. 2 & 3 in Dist. Ct.) (single, hair-thin glass fiber could provide over 1,500 channels). And telephone companies could provide essentially unlimited amounts of video programming through interactive services like video on demand, which would allow consumers to select (and view at their leisure) shows and movies from video libraries with no inherent limits. JA 151-52, 169-70, 288-89. Thus, it was undisputed on the record below that these first two categories of "alternatives" would exclude 99% of the programming that Bell Atlantic would supply directly to consumers in the absence of § 533(b). JA 288.

Third, the Solicitor General now stresses an additional category of supposed alternatives using new and unproven services, such as wireless cable ("MMDS") or direct broadcast satellite ("DBS"). Neither of these alternatives is remotely adequate. In

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[28] In practice, leased access channels also remain subject to the editorial control of cable operators. JA 284, 289-90. Congress itself has concluded that "leased access has not been an effective mechanism for securing access for programmers to the cable infrastructure or to cable subscribers." H.R. Rep. No. 628, 102d Cong., 2nd Sess. 39 (1992); *see also* Donna N. Lampert, *Cable Television: Does Leased Access Mean Least Access?*, 44 FED. COMM. L.J. 245, 248 (Mar. 1992) ("the access provisions of the Cable Act have wholly failed to serve their intended purpose").

contrast to the existing telephone network, which reaches 100 million subscribers nationwide, DBS and MMDS have yet to achieve more than 1 percent of market penetration after more than two decades of development.[29] Moreover, both DBS and MMDS are broadcast technologies licensed by the government, and licenses are in short supply.[30]

In short, neither DBS nor MMDS is the kind of demonstrably adequate, "practical substitute[]" that intermediate scrutiny demands. *Ladue*, 114 S. Ct. at 2046; *Linmark Associates, Inc. v. Willingboro*, 431 U.S. 85, 93 (1977). Accordingly, § 533(b) is unconstitutional for the separate reason that it fails to leave open adequate alternative channels for communication.

III. THE FCC'S THIRD REPORT AND ORDER CANNOT "SAVE" SECTION 533(b)

Throughout this case, petitioners have advanced a series of procedural smokescreens to avoid a decision on the merits. In the District Court, the Government challenged Bell Atlantic's standing.

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[29] "[L]ess than 1 percent of . . . multichannel service consumers get their television from direct broadcast satellites." 141 Cong. Rec. S 8422 (June 15, 1995) (statement of Sen. Lieberman). DBS systems broadcast the same programming nationwide, with no opportunity to carry the local broadcast stations that still account for some two-thirds of audience viewing time (*1994 Competition Report* at ¶ 97), or to tailor programming to local audiences as Bell Atlantic proposes. JA 150, 172.

Similarly, "wireless cable has not achieved significant penetration nationwide," reaching only about half a million subscribers. *1994 Competition Report* at ¶ 79. Wireless cable transmitters must have line-of-sight access to customer homes in order to deliver programming. Consequently, many homes are unable to receive service from this technology because they are blocked by trees, hills, or buildings. According to the FCC, the average wireless cable operator has access to only 75 percent of the homes in its service area. *Id.* at ¶ 87.

[30] MMDS operators "have [had] difficulty in gaining access to a sufficient number of channels to provide competitive service," because holders of licenses have "warehoused" channels for future use. *1994 Competition Report* at ¶ 85. The FCC has been working on licensing DBS systems since 1980. Notice of Inquiry, *Direct Broadcast Satellites*, 45 Fed. Reg. 72719 (Nov. 3, 1980). To date, only three systems are operational.

Pet. App. 66a-69a. In its rehearing petition in the Court of Appeals, NCTA suggested that the court vacate its judgment in light of a supposedly new-found "saving construction" of the statute that in fact had been briefed and argued from the very beginning of the case.[31] On certiorari, petitioners urged this Court to vacate the Court of Appeals' judgment and remand the case in light of the FCC's reinterpretation of its "good-cause waiver" authority in the *Third Report and Order*. This Court declined to do so. 115 S. Ct. 2608 (1995).

There is no reason to take petitioners' "saving construction" more seriously at this stage.

1. The *Third Report and Order* is nothing more than a statement of the FCC's unilateral intent, subject to change at any time in the Commission's discretion, to permit telephone companies to provide video programming under certain circumstances and pursuant to unspecified "terms and conditions" still to be devised by the Commission. Supp. Br. App. 6a n.11, 13a-14a. As such, it provides no reason for this Court to refrain from holding § 533(b) unconstitutional.[32] Whether in the end the Commission will in fact adopt a "more speech-friendly" plan (Supp. Br. App. 3a) — or whether the terms will even be economically or technologically feasible — remains to be seen.

The history of the FCC's decisionmaking in this area is not reassuring. The FCC has been studying and proposing the

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[31] Petitioners repeat here the suggestion that the saving construction was not presented to the courts below. Govt. Br. 39; NCTA Br. 17, 27. If that were true, this Court should adhere to its usual prudential rule in federal cases of declining to decide issues not raised or resolved in the lower court. *E.g.*, *Taylor v. Freeland & Kronz*, 503 U.S. 638, 646 (1992). In fact, however, the saving construction was briefed in, and properly rejected by, the courts below. *See* Response to Petitions for Cert. at 16-20 (May 30, 1995).

[32] *See Northeastern Florida Contractors v. Jacksonville*, 113 S. Ct. 2297, 2301 (1993) ("a defendant's voluntary cessation of a challenged practice does not deprive a federal court of its power to determine the legality of the practice"); *City of Mesquite v. Aladdin's Castle, Inc.*, 455 U.S. 283, 289 (1982) (repeal of law does not prevent judicial review because repeal "would not preclude [the city] from reenacting precisely the same provision if the District Court's judgment were vacated").

elimination of § 533(b) since 1987.[33] But not until May 16, 1995 — nearly two years after the Commission was first enjoined from enforcing the ban and on the eve of the filing of the Solicitor General's petition for certiorari in this case — did the Commission suggest taking any action. In recently voting to repeal § 533(b), Members of Congress criticized the Commission for its tardiness.[34]

Indeed, the FCC has twice banned telephone companies from providing video programming over their networks despite outstanding federal court orders to the contrary.[35] If this Court overturns those orders, there will be nothing to stop the FCC from abandoning the *Third Report and Order* entirely, reinstating a narrow good-cause waiver policy, and resuming strict enforcement

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[33] In 1987, the FCC issued a Notice of Inquiry proposing re-examination of § 533(b). 2 FCC Rcd 5092, 5093 (1987). The next year, it issued a Further Notice of Inquiry and Notice of Proposed Rulemaking tentatively concluding that § 533(b) should be eliminated. 3 FCC Rcd 5849, 5851, 5865 (1989). After a four-year delay, the Commission formally reaffirmed that conclusion. *Video Dialtone Order*, 7 FCC Rcd at ¶¶ 135-43.

[34] *See, e.g.*, 141 Cong. Rec. S 7965 (June 8, 1995) (statement of Sen. Craig) ("It has taken more than 4 years for the FCC to create a general framework for video dial tone, and with each successive ruling more and more constraints have been placed on telephone companies wishing to offer cable TV services. That is not the way to foster competition. And it is not giving consumers the additional cable choices they have all asked for and they think in a free market they ought to be able to receive. In effect, the FCC 4-year delay has prevented robust competition in the cable industry.").

[35] Even though the FCC is bound by a district court order enjoining enforcement of § 533(b) — which it has never sought to stay — the FCC has denied Bell Atlantic the right to provide video programming over an approved video dialtone system in Dover Township, New Jersey. Order and Authorization, *Application of New Jersey Bell Tel. Co.*, 9 FCC Rcd 3677, 3690 (1994). Bell Atlantic asked the FCC to reconsider its decision as inconsistent with the injunction, but the request remains pending with the FCC more than a year later, *Petition of Bell Atlantic-New Jersey for Limited Reconsideration*, File No. W-P-C 6840 (Aug. 17, 1994), despite a statutory 90-day deadline for ruling on reconsideration requests. 47 U.S.C. § 405(b)(1). The Commission recently prohibited another telephone company from speaking on its video dialtone system, notwithstanding another federal court order to the contrary. *See* Memorandum Opinion and Order on Recon., at ¶ 8, *Application of Ameritech Operating Companies*, File Nos. W-P-C 6926, *et al.* (Oct. 6, 1995).

of what the FCC calls "the absolute ban contained in the statute." Supp. Br. App. 4a. The FCC issued its *Third Report and Order* only in reaction to judicial decisions holding § 533(b) unconstitutional. *Id.* at 6a-7a & n.13. In fact, the Commission's admitted goal was to "make it unnecessary for [the Supreme Court] to decide whether a complete prohibition on video programming by telephone companies in their exchange areas is constitutional." *Id.* at 7a. Unless this Court affirms the judgment below, a principal basis of the FCC's action would disappear. The Commission has warned telephone companies that, "[i]f the government prevails in the Supreme Court, we will have to conduct further proceedings to determine how best to bring the parties into compliance with the Court's judgment." Fourth Report and Order, at ¶ 25, *Telephone Company-Cable Television Cross-Ownership Rules*, CC Docket No. 87-266, FCC 95-357 (Aug. 14, 1995).

2. Petitioners' "saving construction" is in any event not a plausible interpretation of § 533(b). Although statutes are construed to avoid constitutional difficulties, "'avoidance of a difficulty will not be pressed to the point of disingenuous evasion.'" *Rust v. Sullivan*, 500 U.S. 173, 191 (1991) (quoting *George Moore Ice Cream Co. v. Rose*, 289 U.S. 373, 379 (1933)).

The *Third Report and Order* purports to change § 533(b) from what the Commission calls an "absolute ban," Supp. Br. App. 4a, to a restriction that the Commission can "routinely" waive at its option. *Id.* at 19a. Yet the statutory language of § 533(b)(4) indicates that waivers are available only on the basis of "the particular circumstances demonstrated by the petitioner."[36] Section

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[36] Section 533(b)(4) provides:

> In those areas where the provision of video programming directly to subscribers through a cable system demonstrably could not exist except through a cable system owned by, operated by, controlled by, or affiliated with the common carrier involved, or upon other showing of good cause, the Commission may, on petition for waiver, waive the applicability of paragraphs (1) and (2) of this subsection. Any such waiver shall be made in accordance with section 63.56 of title 47, Code of Federal Regulations (as in effect September 20, 1984) and shall be granted by the Commission upon a finding that the issuance of such waiver is justified by the particular

533(b)(4) also references "section 63.56 of title 47, Code of Federal Regulations (as in effect September 20, 1984)," which prescribes a series of procedures for case-by-case, fact-specific inquiries focusing on exceptional circumstances — a test that is inconsistent with the broad waiver standard now proposed by the FCC.[37] The Commission may not simply rewrite a section of the Communications Act. *MCI Telecommunications Corp. v. AT&T*, 114 S. Ct. 2223 (1994).

Not surprisingly, the *Third Report and Order* flies in the face of the only authoritative judicial interpretation of § 533(b)(4). In *National Cable Television Ass'n v. FCC*, 914 F.2d 285 (D.C. Cir. 1990), the Court of Appeals, at the urging of the NCTA, reversed a good-cause waiver granted by the Commission to a telephone company affiliate to participate in the operation of an experimental fiber-optic system in a single California community — a much more limited request than the sea change proposed by the *Third Report and Order*. The Court of Appeals disagreed that the Commission "enjoyed considerable latitude" in granting good cause waivers. *Id.* at 288. The court explained that "[t]he policy of the subsection, which the Commission must take into consideration, is to prohibit" telephone company video programming. *Id.* at 289. The court held that a waiver was unavailable absent a showing that telephone company participation was "necessary" to the construction or operation of a cable system. *Id.*

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circumstances demonstrated by the petitioner, taking into account the policy of this subsection.

[37] Indeed, that approach conflicts with the concept of "good cause waiver" as it is used throughout the U.S. Code. For example, an agency could not use the good cause exception for notice and comment procedures, 5 U.S.C. § 553, to decide that it will depart on a "routine" basis from Administrative Procedure Act requirements. *Buschmann v. Schweiker*, 676 F.2d 352, 357 (9th Cir. 1982) ("good cause" exception "is essentially an emergency procedure"). Nor could a U.S. Attorney's office use the "good cause" provision of the Speedy Trial Act to declare that it will "routinely" extend the 90-day period provided in 18 U.S.C. § 3161. *E.g.*, *Furlow v. United States*, 644 F.2d 764, 767 (9th Cir.), *cert. denied*, 454 U.S. 871 (1981) (Mt. St. Helen's eruption satisfied "good cause" requirement). *See also Kleem v. INS*, 479 U.S. 1308 (1986) (Scalia, Circuit Justice) (construing "good cause" rule of 28 U.S.C. § 2101(c)).

The *Third Report and Order* also contradicts the Commission's previous construction of its waiver authority. The FCC previously held that "it 'is the policy of this subsection [§ 533(b)] that telephone companies should be prohibited from providing video programming directly to subscribers in their telephone service areas. The waiver authority should be narrowly construed and exercised in a manner that does not undermine the basic policy of this subsection.'"[38] The *Third Report and Order* barely acknowledges this radical shift in the Commission's interpretation, let alone attempts to explain it, as the FCC was required to do.[39] For its part, the NCTA previously has argued for a limited view of § 533(b)(4).[40]

3. Even if valid, the construction is not a "saving" one. If anything, it *compounds* the constitutional infirmity in § 533(b) by vesting the Commission with impermissibly broad licensing power over telephone company speech. In fact, by illustrating how the FCC can dramatically expand and contract its waiver authority at will, the *Third Report and Order* underscores just how vast the Commission's discretion is. The Commission unilaterally promises that it will "routinely" grant waivers so long as "the telephone company agrees to abide by the regulations we will establish governing its provision of video programming." Supp. Br. App. 19a. But under the *Third Report and Order*, telephone company

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[38] *Telephone Company-Cable Television Cross Ownership Rules*, 3 FCC Rcd 5849, 5850 (1988) (quoting 130 Cong. Rec. H 10,444 (daily ed. Oct. 1, 1984)); *see also* 1970 Order at ¶ 11 (waiver policy "should be on a case-by-case basis, . . . rather than by any blanket exemption"); JA 43 n.7 (waiver standard imposes a "high burden"); Br. of Government in *Ameritech Corp. v. United States*, No. 95-1223, at 43 (7th Cir.) (filed Mar. 13, 1995) (admitting that the possible re-interpretation of § 533(b)(4) "would constitute a significant change in the agency's prior understanding of the statutory requirements").

[39] *See Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42 (1983); *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 212 (1988) (agency "litigating positions" not entitled to deference).

[40] *See, e.g.*, Br. of Petitioner in *NCTA v. FCC*, No. 89-1517, at 37 (D.C. Cir. filed Apr. 6, 1990) ("Congress has instructed that [the FCC's] waiver authority must be narrowly construed").

video speech will still be illegal until the Commission decides whether, when, and how to allow it. The Commission has the power to create, and to change, the still-to-be-developed terms and conditions for granting waivers, and there is no specified time within which the Commission is required to act on waiver applications.[41] It was stipulated in this case that waiver applications have languished for years before the Commission. *See* JA 204-05.[42]

Thus, the good-cause waiver authority is itself an open-ended grant of standardless licensing power, in violation of the fundamental principle that the government "cannot vest restraining control over the right to speak [in] an administrative official where there are no appropriate standards to guide his action." *Kunz v. New York*, 340 U.S. 290, 295 (1951).[43] For First Amendment

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[41] "[T]he failure to confine a time within which the licensor must make a decision contains the same vice as a statute delegating excessive administrative discretion." *FW/PBS, Inc. v. City of Dallas*, 493 U.S. 215, 226-27 (1990); *see also City of Lakewood*, 486 U.S. at 771; *Riley*, 487 U.S. at 802.

[42] Waiver applications contested by cable incumbents have taken as long as 1,113 days for the FCC to process. *Bentleyville Telephone Co., Petition for Waiver of Sections 63.54 and 63.55 of the Commission's Rules and Application for Authority to Construct and Operate a Cable Television System Within Its Telephone Service Area*, File No. W-P-C 6817 (May 16, 1995). Likewise, applications to deploy facilities for video dialtone service, which the Commission has held are an essential prerequisite to providing programming, have been substantially delayed. For example, one application is still pending after nearly three years. *Application of New Jersey Bell*, File No. W-P-C 6838 (filed Nov. 16, 1992). *See* 141 Cong. Rec. S 8193-94 (June 12, 1995) (statement of Sen. Kerrey) ("telephone companies saw their applications to offer [video dialtone] languish as agency officials insisted on changes in many plans. Today, only a handful of tiny experiments exist").

[43] The Government insists that this principle is inapplicable because the waiver supposedly will not be explicitly based "on the content of the speech." Govt. Br. 41. But the same could have been said in *City of Lakewood*, 486 U.S. at 755-59, 769-72, *FW/PBS, Inc.*, 493 U.S. at 225-26, *Riley*, 487 U.S. at 801-02, *Secretary of State of Maryland v. J.H. Munson Co.*, 467 U.S. 947, 964 n.12 968 (1984), *Shuttlesworth v. Birmingham*, 394 U.S. 147, 150-51 (1969), *Staub v. City of Baxley*, 355 U.S. 313, 321 (1958), *Saia v. New York*, 334 U.S. 558, 559-61 (1948), *Largent v. Texas*, 318 U.S. 418, 422 (1943), *Schneider*, 308 U.S. at 163-64, and *Lovell*, 303 U.S. at 451.

purposes, the waiver regime in the *Third Report and Order* is no different from a city's flat ban on holding rallies in a public park, accompanied by a promise from the police chief that "good cause" exceptions will be granted according to "speech-friendly" standards to be developed sometime in the future. The technology is different, but the principle is the same.

4. Moreover, far from *avoiding* constitutional issues, the construction raises grave *new* constitutional questions. Instead of permitting each telephone company to provide video programming *either* as a traditional (*i.e.*, non-common carrier) cable provider *or* as one of the programmers on a common carrier video dialtone system — as would the bills recently adopted by each House of Congress[44] — petitioners' "saving construction" would permit telephone companies to provide video speech *only* through video dialtone. Thus, the Government emphasizes that the FCC's waiver policy "requires a common carrier element." Govt. Br. 40.[45] Although some telephone companies might voluntarily choose a video dialtone system to provide video programming (as Bell Atlantic would do in Alexandria, Virginia, *see* JA 13, 214-15, 218), designating such a system as the only option for video speech itself raises grave constitutional questions.

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[44] The Government implies that the bills are limited to the video dialtone option, Govt. Br. 16 n.12, but that is incorrect. For example, H.R. 1555 provides that a telephone company may provide video programming either as a programmer on a video dialtone system or "as a cable service." H.R. 1555, 104th Cong., 1st Sess. § 201 (1995). *See* 141 Cong. Rec. E 1699 (Aug. 11, 1995) (remarks of Rep. Tauzin) (H.R. 1555 "gives all telephone companies the choice between entering video markets as Title II common carriers or as Title VI cable operators."); *see also* S. 652, 104th Cong., 1st Sess. § 202(a) (1995).

[45] Petitioners also attempt to defend the "saving construction" as preventing telephone companies from purchasing incumbent cable systems. Govt. Br. 42, NCTA Br. 31-32. But § 533(b) does not bar telephone companies from owning or buying cable systems. *See* pp. 13-14, *supra*. Moreover, Clayton Act § 7 already bars acquisitions where their effect "may be substantially to lessen competition or tend to create a monopoly." 15 U.S.C. § 18; *see also* JA 249-50. Petitioners have never disputed that "existing antitrust laws could be applied to prohibit telephone companies from acquiring cable companies within their telephone service areas." Respondents' Dist. Ct. Reply Br. 7 (June 5, 1993).

A mandatory common carrier scheme, even if efficiently administered, would dramatically raise the cost of telephone company video speech: If telephone companies wished to provide video programming, they would have to do so through a system that contains sufficient excess capacity to allow a substantial number of other speakers to communicate as well. They could not simply build enough capacity to allow *themselves* to speak.[46] The FCC has suggested that it may preclude a telephone company from speaking on as much as 75% of the capacity on its system. Supp. Br. App. 13a n.34; *Video Dialtone Order*, 7 FCC Rcd at ¶ 143 n.360. Such a draconian limit on the quantity of expression would be far worse even than the displacements of speech that were found invalid in *Hurley*, 115 S. Ct. at 2349-50 (addition of a small group to parade), *Pacific Gas & Elec. Co. v. Public Utilities Comm'n*, 475 U.S. 1, 17-18 (1986) (small insert in "extra space" of billing envelope), or *Miami Herald Pub. Co. v. Tornillo*, 418 U.S. 241, 256-57 (1974) (short reply in newspaper), or than the displacement of a potentially small number of cable channels by the must-carry rules in *Turner*, 114 S. Ct. at 2471-72; *see also* Br. of Govt. Respondents in *Turner*, No. 93-44 at 30 ("If the operators are right, . . . 98% of the broadcast stations that are entitled to be carried . . . would be carried in any event").

That a telephone company is a common carrier for purposes of voice transmissions does not mean that it may be forced to *speak* only as a common carrier.[47] And the FCC's requirement would

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[46] NCTA concedes that the FCC's waiver policy will be "distinctly objectionable" to those telephone companies that want to build only enough transport capacity to carry their own video speech. NCTA Br. 29 n.23.

[47] It is axiomatic that a telecommunications company "may operate as a common carrier with respect to a portion of its service only." *FCC v. Midwest Video Corp.*, 440 U.S. 689, 701 n.9 (1979); *see also National Ass'n of Regulatory Utility Comm'rs v. FCC*, 533 F.2d 601, 608 (D.C. Cir. 1976) ("Since it is clearly possible for a given entity to carry on many types of activities, it is at least logical to conclude that one can be a common carrier with regard to some activities but not others"); *Southwestern Bell Tel. Co. v. FCC*, 19 F.3d 1475, 1481, 1484 (D.C. Cir. 1994) (whether a service is a common carrier service turns not on telephone company's status overall, but on nature of "the particular practice under surveillance").

raise major Takings Clause concerns as well, for commandeering a portion of the telephone network for mandatory common carriage of video signals would seem to be an uncompensated electronic occupation of private property that is in principle indistinguishable from the law invalidated in *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982). *See also Midwest Video Corp. v. FCC*, 571 F.2d 1025, 1057 (8th Cir. 1978) (FCC rule requiring cable companies to build excess capacity and operate in part as a common carrier constituted a taking in violation of the Fifth Amendment), *aff'd on other grounds*, 440 U.S. 689 (1979).[48]

Neither the *Third Report and Order* nor petitioners' briefs confront any of these difficult questions. Hence, the proper disposition of this case is to hold § 533(b) facially invalid. If the Government believes that a different regulatory regime would be permissible, it is free to adopt that scheme and let its constitutionality be adjudicated in due course. But it cannot simply ban telephone company video speech in the interim.

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[48] *PruneYard Shopping Center v. Robins*, 447 U.S. 74 (1980), does not suggest a different result. "Notably absent from [*PruneYard*] was any concern that [the state law] might affect the shopping center owner's exercise of his own right to speak." *Pacific Gas & Elec. Co.*, 475 U.S. at 12; *see id.* at 23-24 (Marshall, J., concurring in judgment) ("While the shopping center owner in *PruneYard* wished to be free of unwanted expression, he nowhere alleged that his own expression was hindered in the slightest.").

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted.

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FOR ARGUMENT

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In the Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, ET AL.,
PETITIONERS

v.

THE CHESAPEAKE AND POTOMAC TELEPHONE
COMPANY OF VIRGINIA, ET AL.

NATIONAL CABLE TELEVISION ASSOCIATION, INC.,
PETITIONER

v.

BELL ATLANTIC CORPORATION, ET AL.

ON WRITS OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

REPLY BRIEF FOR THE FEDERAL PETITIONERS

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1. a. Respondents argue (Br. 13) that strict scrutiny extends to "bans * * * that tell speakers * * * , even in a content-neutral way, that they may not provide, at any time or place, speech to the audience and in the manner of their choosing." Even if that somewhat ambiguous formulation accurately states the law, it does not apply here, for 47 U.S.C. 533(b) does not foreclose respondents from an "entire medium of expression." Cf. *City of*

Ladue v. *Gilleo*, 114 S. Ct. 2038, 2045 (1994).[1] Respondents may offer video programming over their own local broadcast television stations (or even a national television network), and they may set up "cable channels" of their own programming, which could be disseminated over independently controlled cable systems. Under those arrangements and several others, respondents could show their own video programming.[2] See Gov't Opening Br. 30-31, 37-38. Respondents may not (absent a waiver) offer programming over their own cable systems in their service areas because of the regulatory problems with such an arrangement, but that specific and limited restriction is a "manner" regulation properly analyzed under inter-

[1] Respondents rely heavily on *Ladue* for the application of strict scrutiny. While we do not question that *Ladue* expressed "particular concern with laws that foreclose an entire medium of expression," 114 S. Ct. at 2045, it is questionable whether *Ladue* applied strict scrutiny. The bulk of the discussion in *Ladue* assumed the applicability of intermediate scrutiny and concluded that the ban on residential signs failed that scrutiny. *Id.* at 2046-2047; see also *id.* at 2047 (O'Connor, J., concurring). In *City of Lakewood* v. *Plain Dealer Publishing Co.*, 486 U.S. 750, 763 (1988), the Court stated, when discussing a hypothetical municipal ban on all newsracks: "Presumably in the case of an ordinance that completely prohibits a particular manner of expression, the law on its face is both content and viewpoint neutral. In analyzing such a hypothetical ordinance, the Court would apply the well-settled time, place, and manner test." That statement is directly contrary to respondents' formulation of the law. In any event, the Court need not decide whether restrictions on an "entire medium of expression" always require strict scrutiny, for, as we explain in the text, no such restriction is at issue in this case.

[2] For the same reasons, respondents' argument (Br. 34-36) that Section 533(b) fails to leave open ample alternative channels of communication is unfounded. Section 533(b) does not ban local exchange carriers (LECs) from the video medium, but permits them to gain direct access to audiences through the dominant mode of broadcast television, as well as through direct-broadcast satellite television and "wireless cable." See Gov't Opening Br. 37-38. Through those modes of delivery, LECs can have guaranteed access to their desired audience, without the need to rely on unaffiliated cable-system operators.

mediate scrutiny—just as the ban on ambulatory fairground proselytizing at issue in *Heffron* v. *International Society for Krishna Consciousness, Inc.*, 452 U.S. 640 (1981), and the ban on residence-specific picketing at issue in *Frisby* v. *Shultz*, 487 U.S. 474 (1988), were so analyzed.

Respondents' reliance on *Hurley* v. *Irish-American Gay, Lesbian and Bisexual Group of Boston*, 115 S. Ct. 2338 (1995), is misplaced. There, the Court identified the problem with compelled inclusion in the parade as one of forced association with the *content* of a particular message. See *id.* at 2348, 2350. The Court distinguished *Turner Broadcasting System* v. *FCC*, 114 S. Ct. 2445 (1994), in which it applied intermediate scrutiny, on the basis that the must-carry rule at issue in *Turner* carried "little risk that cable viewers would assume that the broadcast stations carried on a cable system convey[ed] ideas or messages endorsed by the cable operator." *Hurley*, 115 S. Ct. at 2348-2349 (quoting *Turner*, 114 S. Ct. at 2465). *Hurley* is therefore closer to a case involving regulation of content, albeit in the context of the right not to speak messages of a particular content, than to a case like this one.

b. Respondents also argue that Section 533(b) is content-based. The only distinction made by Section 533(b), however, involves the method by which a message is disseminated. The distinction is no more content-based than would be (for example) a regulation of live entertainment, but not television, in taverns. We agree that each method of presentation of an idea has its own important qualities, but that point does not convert a regulation of the mode of delivering a message into one governing the content of the message. See *Leathers* v. *Medlock*, 499 U.S. 439, 449 (1991) (tax applied only to cable services is not content-based).

Section 533(b) also does not present the threat of administrative discretion over speech. This is not a situation in which there is "unfettered discretion, coupled with the power of prior restraint." *City of Lakewood* v. *Plain*

Dealer Publishing Co., 486 U.S. 750, 757 (1988). The Federal Communications Commission (FCC) abjures authority to apply Section 533(b) based on the content of any message presented. See Gov't Opening Br. 21-22. Even if, in rare cases, it will be difficult to determine whether programming is covered by Section 533(b), those cases can be resolved without "need to evaluate the nature of the message being imparted." *Regan* v. *Time, Inc.*, 468 U.S. 641, 656 (1984). As long as the distinctions made are content-neutral, "perfect clarity and precise guidance [are not] required even of regulations that restrict expressive activity." *Ward* v. *Rock Against Racism*, 491 U.S. 781, 794 (1989).

2. a. Respondents assert that there is a "mismatch" between the problem of cross-subsidization and the restriction enacted by Section 533(b). They question why cross-subsidization does not occur under the current regime, under which local exchange carriers (LECs) may operate video transport services without exercising editorial control. Resp. Br. 23. This is the same error as that made by the district court. See Gov't Opening Br. 25-27. The danger of cross-subsidization in the existing video transport market is small because the potential profit from that market is much smaller than the profits that can be derived from offering full cable services. See *In re Tel. Co.—Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Further Notice of Inquiry and Notice of Proposed Rulemaking*, 3 F.C.C. Rcd 5849, 5857 (1988). The 1980 FCC staff study that reexamined the FCC's cross-ownership rules reached a similar conclusion, that LECs might not have the incentive to build a cable system unless they exercised substantial editorial control. J.A. 69. But if LECs were permitted to provide their own video programming over their transport facilities, the prospect of dominating the lucrative video programming market would provide a greater incentive for them to cross-subsidize transport costs. "Simply put, the removal of

§ 533(b) would make a video transmission monopoly more valuable to a telephone company." J.A. 332 (Owen reply affidavit). Congress has, accordingly, tailored the cross-ownership bar to the situation in which the danger of cross-subsidization is much more substantial. Respondents' underinclusiveness argument is thus ill-founded, as well as contrary to the principles favoring narrow tailoring in First Amendment jurisprudence.[8]

Respondents also argue (Br. 25-27) that the danger of cross-subsidization is attenuated because the FCC and several States have adopted price-cap regulation for common carrier telephone service. The FCC's price-cap rules, however, cover only interstate services of LECs (providing customers with access to long-distance companies), and do not address the cost to customers of LECs' monopoly local telephone service, which is regulated by the States. See *In re Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order*, 5 F.C.C. Rcd. 6786, 6787 (1990) (*Price-Cap Order*), aff'd on reconsideration, 6 F.C.C. Rcd 2637 (1991), aff'd *sub nom. National Rural Telecom Ass'n* v. *FCC*, 988 F.2d 174 (D.C. Cir. 1993). Most States have not adopted "pure" price-cap regulation for LECs; price-cap regulation remains controversial, and many consumer interests and state utility regulators maintain that rate-of-return regulation has advantages for local telephone customers. See *In re Policy and Rules Concerning Rates for Dominant Carriers*,

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[8] Respondents also suggest (Br. 23-24) that LECs would have a strong financial stake in the success of an unaffiliated cable operator since they could obtain rental income from such an operator. But that rental income could be subject to traditional rate regulation by the States and would not be calculated as a share of the unaffiliated programmer's profits in the programming market. See Gov't Opening Br. 26. Even on the opposite assumption, the indirect benefits from cross-subsidization that could be obtained from that rental income, or from a five percent ownership share in a cable operator (Resp. Br. 23), are surely minimal compared to the benefits that could be gained from cross-subsidization if the LEC fully owned a cable system in its service area.

Further Notice of Proposed Rulemaking, 3 F.C.C. Rcd 3195, 3212, 3217, 3260 (1988). State rate-of-return regulation "in its present form has been with us for some time" (*Price-Cap Order*, 5 F.C.C. Rcd at 6789), and is not on the verge of disappearance.

b. Respondents argue (Br. 27-29) that Section 533(b) is not necessary to prevent LECs from discriminating against their competitors in affording access to essential facilities for the distribution of video programming. Experience teaches that common carriers have the incentive and opportunity to discriminate against their competitors when they are permitted to carry for their own benefit as well as others'. See *Delaware, L. & W.R.R.* v. *United States*, 231 U.S. 363, 370 (1913); *United States* v. *Reading Co.*, 253 U.S. 26, 60-61 (1920); *United States* v. *Elgin, J. & E. Ry.*, 298 U.S. 492, 504 (1936) (Stone, J., dissenting); Gov't Opening Br. 5-6 n.6. That problem has not been obviated in this context by the Pole Attachments Act of 1978, 47 U.S.C. 224, as respondents maintain. While that Act does set up a regulatory regime to mediate disputes between utility companies and cable operators over access charges, "nothing in the [Act] * * * gives cable companies any right to occupy space on utility poles, or prohibits utility companies from refusing to enter into attachment agreements with cable operators." *FCC* v. *Florida Power Corp.*, 480 U.S. 245, 251 (1987). The Act confirms that LECs retain ownership rights in their utility poles, including the right to exclude access to potentially competing cable operators, and merely authorizes the regulation of rents charged by utilities that voluntarily lease pole or conduit space to cable operators. *Id.* at 251-252.

Although cable operators have not until now faced obstacles in gaining access to LECs' poles and conduits (Resp. Br. 27-28), that point is evidence of the effectiveness of Section 533(b), not its obsolescence. Because LECs may not compete with cable operators in their serv-

ice areas, they have no incentive to exclude them from poles and conduits. The same would not be true if respondents were permitted to operate their own cable systems in their service areas. Respondents' pole attachment and conduit agreements typically provide for termination, by either party, on six months' notice (see J.A. 113, 211); thus, within six months of entering the cable market (or even anticipating entry), respondents could demand that competing cable operators remove cable wires from their utility poles. Even if LECs did not engage in such an obvious form of discrimination, they could use their control over their poles and conduits to frustrate competitors' ability to maintain the condition of their equipment. See Gov't Opening Br. 36.

Respondents suggest (Br. 28-29) that independent video programmers would benefit if LECs could offer another conduit for their programming, in competition with the incumbent cable systems. But it is doubtful that such programmers would benefit substantially if they faced two duopolists rather than one monopolist, or if LECs simply replaced the incumbent cable operators as monopolists. Independent programmers would benefit from a second conduit if they had some right of access, as under the common-carriage video dialtone regime planned by the FCC, but respondents deny that Congress can even require them to carry the voices of others over their video dialtone systems. Resp. Br. 44-45. In their view, the right to editorial control over video dialtone is an all-or-nothing matter, and they cannot be forced to share their networks with any other programmers. That argument confirms the FCC's insight in 1970 that LECs' control over the system of disseminating video programming could lead to an "arbitrary blockage of th[e] gateway." See Gov't Opening Br. 6.

c. Respondents also contend (Br. 29-32) that Section 533(b) cannot stand because "administrative convenience" is not sufficient to justify a regulation of speech

under intermediate scrutiny. The problem, however, is not one of convenience, but of efficacy. Cross-subsidization and discrimination are inherently difficult to detect and to prove. Because of that difficulty, the question for Congress was how to design a system for "the prevention of harm before it occurs." *Ohralik* v. *Ohio State Bar Ass'n*, 436 U.S. 447, 464 (1978). Congress decided to enact a prophylactic rule that protects video programmers from the threat of LECs' anti-competitive behavior by removing the incentive for that behavior. Absent the prophylactic rule, there will surely be greater incentive and opportunity for anti-competitive conduct by the LECs and greater difficulty in detecting that conduct. Congress's decision should therefore be upheld as a reasonable legislative determination that a prophylactic rule serves the government's important interests more effectively than some other "imaginable alternative that might be less burdensome on speech," *United States* v. *Albertini*, 472 U.S. 675, 689 (1985), for "[a]bsent this requirement, the [government's] interest would have been served less well." *Ward*, 491 U.S. at 800.[4]

The suggestion that courts and agencies have swept aside the accumulated evidence of the danger of anti-competitive behavior by LECs (Resp. Br. 30-31) is seriously overstated. When the D.C. Circuit approved the removal of the barrier to LECs' entry into the in-

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[4] Section 533(b) is also not subject to attack on the theory that it penalizes speech with a "bad tendency," as *amicus* American Civil Liberties Union suggests (Br. 17). In *Gitlow* v. *New York*, 268 U.S. 652 (1925), the Court reasoned that the speaker's conviction was valid under the First Amendment because "the legislative body itself has previously determined the danger of substantive evil arising from utterances of a *specified character*." *Id.* at 671 (emphasis added). But in Section 533(b), Congress was not concerned with utterances of a "specified character," or indeed of any character; the cross-ownership rule is content-neutral. Section 533(b) is not addressed to *speech* with a "bad tendency," but to economically motivated anti-competitive behavior in the market for cable services.

formation services market established in the Bell System modified final judgment, it observed that many "distinguished economists" had concluded that LEC participation in that market would be anti-competitive, and it acknowledged that those "distinguished experts may * * * be 'right'." *United States* v. *Western Elec. Co.*, 993 F.2d 1572, 1581-1582, cert. denied, 114 S. Ct. 487 (1993). The D.C. Circuit's decision was predicated on principles of deference to the regulatory decision-maker—there, the Department of Justice, which had concluded that, on balance, competition and consumer welfare would be increased by provision of information services by the Bell-affiliated LECs. *Ibid.*[5] Here, it is Congress (which is ultimately responsible for setting the nation's telecommunications policy) that has decided that competition in the cable services market requires exclusion of the LECs (in their service areas), and it is that decision that must be upheld as reasonable.

Moreover, it cannot be accepted that public statements by an agency expressing doubt about the wisdom or policy of a regulation are conclusive evidence of its unconstitutionality. Cf. *Rostker* v. *Goldberg*, 453 U.S. 57, 80-81 (1981). Adoption of that view would chill agencies from urging Congress to reexamine a law that is subject to non-frivolous constitutional doubt. In any event, neither the FCC nor other agencies have concluded that regulatory alternatives to Section 533(b) would eliminate all risk of anti-competitive conduct. The FCC has concluded that regulatory controls short of a cross-ownership bar would be "adequate," in the sense that the costs of effective

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[5] The D.C. Circuit did not conclude, as respondents suggest (Br. 31), that any contrary conclusion about the costs and benefits of LEC entry into information services would have been clearly erroneous. It held only that, in light of the deferential standard of review to be applied to the Department of Justice's conclusions, it would have been clearly erroneous for the district court to find that the Department of Justice's conclusion was unreasonable. 993 F.2d at 1582.

regulatory oversight and any residual anti-competitive conduct that might escape such oversight would be outweighed by the benefits to competition of LEC entry into the cable services market.[6] It has not concluded that regulatory controls are equally effective as a cross-ownership bar in preventing all cross-subsidization and discrimination by LECs. Nor has it suggested that a contrary view is *unreasonable*—which is the standard under intermediate scrutiny. Cf. *Ward*, 491 U.S. at 799. The Department of Justice has also recommended repeal of Section 533(b), but it has closely tied the policy benefits from that repeal to elimination of LECs' monopoly on local telephone service, which would be a sea change in this country's telecommunications regulation. See Gov't Opening Br. 32 n.21.

d. Respondents stress (Br. 32-33) that Congress made no explicit findings in the statute or legislative history detailing the economic theories underlying Section 533(b). Since the bar was not controversial in 1984, when Congress codified it, there was no reason then for Congress to explain in detail the problems to which the bar was addressed. But before Congress reregulated the cable industry in 1992, the bar was "extensively considered by Congress in hearings, floor debate, and in committee." *Rostker* v. *Goldberg*, 453 U.S. at 72. That legislative history is "highly relevant in assessing the constitutional validity" of the statute (*id.* at 75), for it shows that the case had not been made to Congress's satisfaction that Section 533(b) was no longer necessary to protect the cable services market.

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[6] See Gov't Opening Br. 32 n.21; *In re Tel. Co.—Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking*, 7 F.C.C. Rcd 5781, 5848-5849 (1990) (*Video Dialtone Order*), modified in part on reconsideration, *In re Tel. Co.—Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking*, 10 F.C.C. Rcd 244 (1994) (*Video Dialtone Reconsideration Order*).

In a 1990 report concerning legislation addressed in large part to the cross-ownership bar, the Senate Commerce Committee noted the substantial disagreement over whether anti-competitive acts would follow from entry of LECs into the cable market. S. Rep. No. 456, 101st Cong., 2d Sess. 4-8 (1990). It concluded that, because of concerns about "the potential for anticompetitive practices by telephone companies," the time was not ripe for repeal. *Id.* at 9. The Committee charged the FCC with further consideration of the issue (*ibid.*), but that charge is fully consistent with its own conclusion that repeal was not yet appropriate.[7]

A year later, the same Committee decided against taking action on the cross-ownership bar in the bill that eventually became the 1992 Cable Act, but it held hearings on another bill that would have repealed Section 533(b), at which it was provided with detailed reasons why the bar should be retained.[8] That bill never emerged from the Committee. The issue was also thoroughly aired in hearings in the House of Representatives, and supporters of the repeal took the issue to the floor of both Houses, where they expressed opposition to the 1992 Cable Act in part because it made no provision for entry

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[7] Respondents note that, in its 1991 report on cable legislation, the Senate Commerce Committee stated that it had previously decided that the cross-ownership bar should be considered "separately." Resp. Br. 33 (quoting S. Rep. No. 92, 102d Cong., 1st Sess. 18 (1991)). Indeed, in a 1990 report on a cable reregulation bill, the Senate Commerce Committee did state that it would consider the matter of LEC entry into the cable market separately. See S. Rep. No. 381, 101st Cong., 2d Sess. 17 (1990). But the Committee considered that issue separately only two months later, and then decided against repeal of Section 533(b). See S. Rep. No. 456, 101st Cong., 2d Sess. 8-9 (1990).

[8] See *Cable-Instructional TV and S. 1200, Communications Competitiveness and Infrastructure Modernization Act of 1991: Hearing Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science, and Transportation*, 102d Cong., 2d Sess. 115-139 (1992).

of LECs into the cable market. See Gov't Opening Br. 10 n.9, 33-34, nn.22, 23. But the push to repeal Section 533(b) failed, and in the 1992 Cable Act Congress took a quite different approach to structural problems in the cable market. Instead of opening up cable services to the full play of market forces—by, for example, allowing LECs to compete with incumbent cable operators—Congress decided to reestablish rate regulation to protect consumer welfare.

Given the wealth of information presented to Congress about the bar before the reregulation of cable in 1992, there can be no doubt that substantial evidence exists to sustain Congress's decision to exclude LECs from the cable market in their service areas. Hence, the statute's prophylactic approach to a complex problem is not based on "speculation and conjecture," but "targets a concrete, nonspeculative harm." *Florida Bar* v. *Went For It, Inc.*, 115 S. Ct. 2371, 2377-2378 (1995). It should, accordingly, be upheld.

3. a. In a series of related arguments, respondents contend (Br. 36-45) that the Court should disregard the FCC's Third Report and Order, in which the FCC concluded that the "good cause" waiver provision of Section 533(b)(4) provides it with authority to permit LECs to provide video programming directly to subscribers in their service areas over a video dialtone system.[9] The Third Report and Order is a definitive administrative construction of Section 533(b)(4), which, under settled principles, must be taken into account when this Court addresses respondents' facial constitutional challenge to Section 533(b) as a whole. See *Forsyth County, Georgia* v. *Nationalist Movement*, 505 U.S. 123, 131 (1992); *City of Lakewood*, 486 U.S. at 770 n.11; *Law Students Civil Rights Research Council* v. *Wadmond*, 401 U.S.

[9] Although respondents rely on mootness cases (Br. 37 n.32), we have not suggested the Third Report and Order renders their constitutional challenge moot.

154, 159, 162-163 (1971); *Poulos* v. *New Hampshire*, 345 U.S. 395, 402 (1953). Under those principles, the Court considers the agency's construction of any related provision that bears on the validity of the principal section under legal attack. See *Ehlert* v. *United States*, 402 U.S. 99, 106-107 (1971).[10]

The FCC's construction is not subject to change at the FCC's whim, as respondents imply. The FCC adopted that construction using the notice-and-comment provisions of the Administrative Procedure Act (APA), 5 U.S.C. 553; any modification of the FCC's construction of Section 533(b)(4) would also have to be undertaken in conformity with the APA, and would be subject to judicial review as well. And although respondents suggest that, "[u]nless this Court affirms the judgment below, a principal basis of the FCC's actions would disappear" (Br. 39), that will not be true if this Court upholds the statute in light of the FCC's construction of Section 533(b)(4). If the Court upholds the statute as construed by the FCC, any subsequent rescission of that construction would only serve to revive quickly respondents' challenge to the complete cross-ownership bar.

b. Respondents insist (Br. 41-43) that the Third Report and Order should be disregarded because the FCC

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[10] In *Ehlert*, the Court rejected the petitioner's challenge to his conviction for failure to submit to induction, which challenge was based on the contention that Selective Service regulations afforded him no opportunity to present a claim of conscientious objection that had "crystallized" after he received the induction notice. Although the Court concluded that the regulations under challenge did generally limit draft boards to considering conscientious objection claims filed before the mailing of the induction notice (402 U.S. at 100 n.1, 104-105), it stressed, based on assurances in a letter "from the General Counsel of the Department of the Army to the Department of Justice," that "late crystallizers" could present a claim of conscientious objection to combatant service after induction into the military (*id.* at 106-107). The Court concluded that the regime as a whole did not bar "late crystallizers" from the opportunity to present their conscientious objection cases.

has not specified the exact terms and conditions under which LECs will be allowed to provide video programming on their own video dialtone systems. There is no basis for any accusation against the FCC of undue delay; in fact, respondent Bell Atlantic requested that the FCC postpone issuance of its regulations until Congress completes action on pending telecommunications legislation.[11] Moreover, fashioning effective regulatory safeguards to replace the cross-ownership bar is a major undertaking. When the FCC recognized, in light of the adverse appellate rulings on Section 533(b), that provision might have to be made to permit LECs to offer their own video programming on their video dialtone systems, it quickly opened rulemaking and asked commenters to address the complex regulatory issues raised by such an arrangement.[12] Those issues include (a) the respective percentages of programming capacity that should be left under LECs' editorial control and should be open to common carriage; (b) "channel-sharing" mechanisms to ensure broad access to video dialtone systems; (c) protections to prevent LECs from misusing unaffiliated programmers' proprietary information; (d) safeguards against cross-subsidization, including accounting rules, structural separation of LECs' telephone and video affiliates, and rules governing transactions between those affiliates; and (e) access for independent programmers to LECs' poles and conduits.[13]

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[11] See Letter of July 21, 1995, from Edward D. Young, III, Vice President and Associate General Counsel of Bell Atlantic Network Services, Inc., to Reed E. Hundt, Chairman of the FCC (lodged with the Clerk of this Court).

[12] The Fourth Circuit denied rehearing in this case on January 18, 1995. Pet. App. 109a-112a. The FCC opened rulemaking two days later. See *In re Tel. Co.—Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Fourth Further Notice of Proposed Rulemaking*, 10 F.C.C. Rcd 4617 (*Fourth Further Notice*). At that time, the government's petition for rehearing in the Ninth Circuit in a similar case was still pending.

[13] See *Fourth Further Notice*, 10 F.C.C. Rcd at 4629-4641. There is also no basis for respondents' suggestion (Br. 38 n.35) that the

The FCC has also made clear that it will grant waivers to LECs that agree to meet the safeguards that are eventually established. See Pet. Supp. App. 19a. The waiver authority therefore is not accurately characterized as a "grant of standardless licensing power" (Resp. Br. 42), for the FCC's discretion is strictly limited by its binding construction of its waiver authority. The restrictions on its discretion have been and will be "made explicit by textual incorporation [and] binding * * * administrative construction," *City of Lakewood*, 486 U.S. at 770, and so the dangers of censorship and self-censorship suggested by respondents do not exist. See also *Poulos*, 345 U.S. at 404-408.

c. On the merits of the FCC's construction of its waiver authority, respondents suggest that the second sentence of Section 533(b)(4) precludes the FCC from offering any generally applicable construction of "good cause" and limits it to case-by-case, fact-specific inquiries.[14] But while Section 533(b)(4) authorizes the FCC

FCC has acted in bad faith by prohibiting two LECs from providing their own programming over their video dialtone systems, notwithstanding an injunction against enforcement of Section 533(b). In both the *New Jersey Bell* and *Ameritech* cases cited by respondents, the FCC permitted a LEC to construct a video dialtone system in its service area. The FCC noted in both cases that the applicant had not requested permission to offer its own video programming over the system, and it therefore limited the approval in both cases to construction and operation of a purely common-carrier video dialtone system. See *In re Application of New Jersey Bell Tel. Co.*, 9 F.C.C. Rcd 3677, 3679 n.27 (1994); *In re Applications of Ameritech Operating Cos.*, No. W-P-C 6926, *et al.*, at 5 (Oct. 6, 1995). Those restrictions were reasonable, for dissemination of a LEC's own video programming over its video dialtone system raises much more complicated regulatory problems of cross-subsidization and discriminaiton than those presented by operation of a pure common-carriage system. Those regulatory problems are, of course, the heart of this case, and they are also the subject of the FCC's ongoing video dialtone rulemaking.

[14] Section 533(b)(4) provides:

> In those areas where the provision of video programming directly to subscribers through a cable system demonstrably

to grant waivers on a showing that the "particular circumstances demonstrated by the [applicant]" warrant a waiver, it does not prohibit the FCC from concluding that all cases falling within a certain class, defined in advance to give adequate notice to the public, will meet the requirement of good cause. Cf. *SEC* v. *Chenery Corp.*, 332 U.S. 194, 202-203 (1947). With respect to the related authorization for waiver based on a showing that cable service in an area "demonstrably could not exist" unless offered by a LEC, the FCC has long had in place a generally applicable rebuttable presumption that such cable service could not exist if the proposed service area has less than a certain household density. See 47 C.F.R. 63.56(b)(2); 46 Fed. Reg. 31,418 (1981). Congress codified that rebuttable presumption by reference in the second sentence of Section 533(b)(4). See n.14, *supra*. Here, the FCC has similarly concluded that, as a rule, the provision of video programming over video dialtone systems, operated in conformity with regulations preventing anti-competitive behavior and in competition with an incumbent cable operator, will constitute "particular circumstances" demonstrating good cause. Pet. Supp. App. 13a. The LEC seeking a waiver must still show that its "particular" proposal to offer video programming on a video dialtone meets those requirements and therefore warrants a waiver.[15]

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could not exist except through a cable system owned by, operated by, controlled by, or affiliated with the common carrier involved, or upon other showing of good cause, the Commission may, on petition for waiver, waive the applicability of paragraphs (1) and (2) of this subsection. Any such waiver shall be made in accordance with section 63.56 of title 47, Code of Federal Regulations (as in effect September 20, 1984) and shall be granted by the Commission upon a finding that the issuance of such waiver is justified by the particular circumstances demonstrated by the petitioner, taking into account the policy of this subsection.

[15] Respondents also suggest that the FCC's construction of "good cause" is too broad (Br. 40 n.37), but "good cause" is not limited

The FCC's construction is not precluded by *National Cable Television Association* v. *FCC*, 914 F.2d 285 (D.C. Cir. 1990), as respondents contend (Br. 40). That case did not involve a situation in which the LEC would have competed with an incumbent cable operator, as will be the case with video dialtone; rather, the LEC would have built the first cable system in the community. Also, that case was decided before the litigation over the constitutionality of Section 533(b). The intervening technological developments and the courts' doubts about the constitutionality of Section 533(b) justified the FCC's revisiting its waiver authority, as the FCC explained in the Third Report and Order. Pet. Supp. App. 11a, 20a-21a.

d. Finally, respondents contend (Br. 43-45) that the Third Report and Order creates constitutional problems because it would require LECs to allow room for others on their video dialtone systems. That assertion is remarkable, for it is a repudiation of the more narrowly tailored alternative that the court of appeals suggested, *viz.*, that

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to dire emergencies. In general, "good cause" refers to something more than speculation. See, *e.g.*, *Schlagenhauf* v. *Holder*, 379 U.S. 104, 119 (1964) (good cause for ordering physical examinations under Federal Rules of Civil Procedure); *Anderson* v. *Cryovac, Inc.*, 805 F.2d 1, 7-8 (1st Cir. 1986) (good cause for entering protective order); *Boeing Airplane Co.* v. *Coggeshall*, 280 F.2d 654, 659 (D.C. Cir. 1960) (good cause for enforcement of subpoena). Beyond that, "[t]here is no settled understanding of what 'good cause' means" (*Southern Ry.* v. *Lanham*, 403 F.2d 119, 126 (5th Cir. 1968)), and the phrase has been aptly described as "a relative and highly abstract term, [such that] its meaning must be determined not only by the verbal context of the statute in which the term is employed, but also by the context of the action and procedures involved and the type of case presented." *Wray* v. *Folsom*, 166 F. Supp. 390, 394 (W.D. Ark. 1958). See also *Dinko* v. *Wall*, 531 F.2d 68, 75 (2d Cir. 1976) ("'Good cause' is an elastic concept, and is often used as a shorthand summary of the underlying policy reasons why a litigant should be able to attain a specified result."). The FCC therefore has the discretion to interpret "good cause" in light of Congress's overarching policy in Section 533(b), the promotion of competition in the cable services market.

Congress could limit LECs to a fixed percentage of the available channels on a cable system and could require them to lease the balance on a common-carrier basis to unaffiliated programmers. See Pet. App. 47a-48a. It is also a repudiation of respondents' position in the lower courts, in which they suggested the shared-system arrangement as an alternative to Section 533(b).[16] But without the alterative proposed by the court of appeals, Section 533(b) must surely be upheld, for no other "obvious less-burdensome alternative" (Pet. App. 47a) effective to prevent anti-competitive conduct has been suggested by the lower courts.

In any event, the Third Report and Order's purported constitutional problems are without substance. The danger in the "compelled speech" cases invoked by respondents is that a speaker "may be forced either to appear to agree with [unwelcome] views or to respond." *Pacific Gas & Elec. Co.* v. *Public Utils. Comm'n*, 475 U.S. 1, 15 (1986) (plurality opinion). But, as the Court observed in *Turner*, must-carry rules in the cable context do not present the same risk, for the public understands that cable operators carry others' messages without endorsing the views expressed in those messages. 114 S. Ct. at 2465-2466; see also *PruneYard Shopping Center* v. *Robins*, 447 U.S. 74, 87 (1980). There is even less danger from "compelled speech" in the context of video dialtone systems, which would be operated by entities well known to the public to be common carriers of others' messages, prohibited from discriminating on the basis of the content of those messages.

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[16] See Resp. C.A. Br. 65 ("Telephone companies that provide their own video programming over their own common carrier networks would remain subject to these nondiscrimination obligations. *Video Dialtone Order*, 7 FCC Rcd at 5850-51[.]"); Tr. C.A. Oral Arg. 27 ("[MR. TRIBE:] There are a lot of things that Congress can do. They can require sharing. They can enforce common carrier obligations to which we are subject.").

For similar reasons, respondents' intimation that the FCC's video dialtone regime effects an unconstitutional taking of their property (Br. 44-45) is without merit. The FCC's plan to allow LECs to speak over their own video dialtone systems does not "take" anything from respondents. To the contrary, it gives them something that they did not previously have, for, at its inception, video dialtone was designed to be a pure common-carriage system based on the current telephone network, over which the LECs could not disseminate their own messages.[17] Since a prohibition against common carriers' use of their facilities for their own benefit does not "take" their property within the meaning of the Fifth Amendment (see *Delaware, L. & W.R.R.* v. *United States, supra*), a more lenient rule, allowing common carriers some use of their own facilities but also requiring them to carry the signals of others, presents no constitutional difficulty.

* * * * *

For the foregoing reasons, and for the reasons set forth in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

NOVEMBER 1995

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[17] See *Video Dialtone Order*, 7 F.C.C. Rcd at 5783; *Video Dialtone Reconsideration Order*, 10 F.C.C. Rcd at 258-259.

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

UNITED STATES OF AMERICA, *et al.*,
Petitioners,
v.
CHESAPEAKE AND POTOMAC TEL. CO. OF VIRGINIA, *et al.*,
Respondents.

NATIONAL CABLE TELEVISION ASSOCIATION, INC.,
Petitioner,
v.
BELL ATLANTIC CORPORATION, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

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REPLY BRIEF FOR PETITIONER NATIONAL CABLE TELEVISION ASSOCIATION, INC.

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REPLY BRIEF FOR PETITIONER NATIONAL CABLE TELEVISION ASSOCIATION, INC.

In seeking affirmance of the Fourth Circuit's invalidation of Section 533(b), Bell Atlantic insists on the most speech-restrictive reading of the statute (BA Br. 36-45) and then, in attacking that interpretation as unconstitutional, only secondarily defends the rationale of the Fourth Circuit (BA Br. 24-25, 27-36). Instead, Bell Atlantic relies primarily on arguments (about strict scrutiny and the advancement of the government interest) that the Fourth Circuit refused to adopt. *Compare* BA Br. 12-18 *with* Pet. App. 20a-33a (strict scrutiny); *compare* BA Br. 21-24, 25-27 *with* Pet. App. 39a (govern-

ment interest). Both parts of this approach, however, are off the mark. First, the statute should not be read, by ignoring one part of it, to ban as much speech as possible, thus inviting constitutional issues that the Commission's recent construction of the full provision serves to avoid. Second, even if Bell Atlantic's more speech-restrictive reading is accepted, the Fourth Circuit was quite correct in recognizing that the validity of the presumptive bar on cable-telephone cross-ownership ultimately comes down to an assessment—a serious assessment—of (a) the adequacy of other possible regulatory checks on the targeted problem of monopoly exploitation and (b) the range and adequacy of alternative avenues of communication left open to the local telephone monopolies. It is simply in the resolution of those issues that the Fourth Circuit went astray.

The Fourth Circuit—even under the most unfavorable reading of the statute, which now is not the governing law as construed by the agency charged with its enforcement—thus made several critical mistakes in its constitutional analysis. On the "narrow tailoring" issue, the court relied dispositively on the availability of alternative regulatory means of attacking the important problems of cross-subsidy and discrimination addressed by the statute (Pet. App. 39a-42a), but it overlooked the central importance to that analysis of assessing the *effectiveness* of such alternative means. *See Turner Broadcasting System v. FCC*, 114 S. Ct. 2445, 2469 (1994). If regulatory solutions were adopted in preference to Section 533(b), the congressional goal of protecting against telephone monopolists' economic abuse through vertical integration would "be achieved less effectively" (*Turner*, 114 S. Ct. at 2469 (internal quotation marks omitted)) than Congress was entitled to demand; and there is no sound basis for holding the contrary as a matter of law. On the "alternative avenues" issue, the Fourth Circuit erred both in fact and in law: it simply overlooked important parts of the actual broad range of avenues of communication left open to local telephone companies like Bell Atlantic; and it mistakenly disregarded the central precedent rele-

vant to judging the legal adequacy of that unrestricted range, *FCC v. NCCB*, 436 U.S. 775 (1978), which held that a company could constitutionally be excluded from publishing a local newspaper while it owned one of the broadcasting franchises in the same community.

Bell Atlantic offers no corrective to these dispositive flaws in the Fourth Circuit's ruling. For those reasons, the challenge to Section 533(b)(1) and (2), if definitively resolved, should be rejected. The provisions justifiably and narrowly target precisely one speech activity—in-region retailing of wire-delivered cable service—that is the very source of the well-recognized problem of otherwise-unpreventable monopoly abuse.

In fact, however, the Court need not resolve that question, because Section 533(b) does not actually impose the "flat ban" that the Fourth Circuit assumed and Bell Atlantic insists it does. The presumptive bar laid down in Section 533(b)(1) and (2) does not stand alone in the statute, but must be read together with Section 533(b)(4), which provides for waivers of the presumptive bar. And the Commission has now recognized, through formal rulemaking, that a flexible construction of the statute's waiver provision is available to allow, under properly tailored regulatory safeguards, precisely what Bell Atlantic accuses the statute of unconstitutionally forbidding—telephone company provision of in-region video programming.

Bell Atlantic, seeking freedom from the very sorts of regulatory safeguards whose availability formed the premise of the Fourth Circuit's ruling, insists that the statute must be read in the most speech-restrictive manner so that it can then be held invalid. But the well-established approach to statutory construction in the face of constitutional concerns is exactly the opposite, and the statutory text readily accommodates a construction that eliminates the Fourth Circuit's constitutional concerns about the broader restriction that it assumed the law imposed. Moreover, Bell Atlantic's new constitutional objection to this construction provides absolutely no ground for a facial invalidation of Section 533(b).

A. Section 533(b)(1) and (2) Survive Intermediate Scrutiny

A statute regulating speech survives intermediate scrutiny if it is narrowly tailored to serve a substantial government interest unrelated to speech and leaves open ample alternative avenues of communication; and the statute is narrowly tailored if the government interest "'"would be achieved less effectively"'" by means other than the congressionally chosen ones. *Turner*, 114 S. Ct. at 2469; *Ward v. Rock Against Racism*, 491 U.S. 781, 799 (1989); *United States v. Albertini*, 472 U.S. 675, 689 (1985); *United States v. O'Brien*, 391 U.S. 367, 377 (1968); *see also, e.g., Rubin v. Coors Brewing Co.*, 115 S. Ct. 1585, 1592 (1995); *Edenfield v. Fane*, 113 S. Ct. 1792, 1798-99 (1993). We agree with Bell Atlantic (*see* BA Br. 19-21) that this standard has real teeth and requires a searching inquiry into the premises of the government action. In this case, however, each element of the test is satisfied.

1. *The Interest Served.* Bell Atlantic does not dispute that the government interest in preventing monopoly abuses like cross-subsidy and access discrimination is an important speech-neutral interest, but it argues that the presumptive cross-ownership bar of Section 533(b) does not serve that interest because the vertical integration targeted by the statute (into unregulated cable service) presents no economic risks not already presented by the activities currently allowed to the local telephone companies (regulated transmission service). BA Br. 21-24, 25-27. This argument is meritless. The evidence in the record, including one of the "undisputed affidavits" of an economic expert (BA Br. 7), attests to the distinctive dangers of regulated monopolists' vertical integration into unregulated retailing. *See* JA 331-36; NCTA Br. 8-12, 37-39. On this point, unsurprisingly, the Fourth Circuit specifically refused to adopt Bell Atlantic's argument (Pet. App. 39a), and the Ninth Circuit expressly rejected the same

contention when made by US West (*US West, Inc. v. United States*, 48 F.3d 1092, 1102 (9th Cir. 1995)). The several interested government agencies, whose views Bell Atlantic elsewhere emphasizes so heavily, also reject the suggestion: the very premise of their legislative proposals—new regulatory safeguards should be adopted if Section 533(b) is repealed—is that vertical integration into cable service presents new, increased problems of monopoly abuse not already presented by the activities currently allowed. *See* NCTA Br. 39 (citing government positions). That is why the Commission has had under way for almost a year a rulemaking proceeding to consider the adoption of such new regulatory safeguards to address the increased problem (short of legislation). *Fourth Further Notice of Proposed Rulemaking*, 10 F.C.C.Rcd 4617, ¶ 34 (1995).

Bell Atlantic simply asks this Court to accept its contrary premise, briefly asserting that there are no common costs (to misallocate) between regulated telephone service and the " 'creation' " of programming. BA Br. 21-22 & n.11. But that is a red herring. What Section 533(b) addresses is not the shooting of movies in Hollywood or the "packaging" of programs in New York for sale to a program retailer, but the direct, wire-based "provision" of any programs or packages to subscribers in the Bell Atlantic region, *i.e.*, the direct retail sale to consumers of a wire-based service.[1] And the evidence in the case, as we

[1] Bell Atlantic's sole citation for its "no common costs" assertion (BA Br. 21-22, citing JA 274-75) makes the same false dichotomy between transmission and "creation and packaging." JA 274. And Bell Atlantic's "no common costs" assertion stands in considerable tension with its argument, in a related context, that vertical integration presents "economies of scope" precisely because of common costs, such as the costs of large computers. *See* Brief of the Bell Company Appellees at 18-19, in *United States v. Western Elec. Co.*, No. 91-5263 (D.C. Cir. Aug. 17, 1992); *see also* J. Thorne, P. Huber, & M. Kellogg, *Federal Broadband Law* § 8.2, at 461-64 & n.13 (1995) (noting that efficiency benefits and common-cost worries are flip sides of the same coin).

have noted, is that the dangers of economic abuse are distinctly greater when the regulated telephone monopolist integrates into a closely related business where it can offer *un*regulated service (the "regulated-unregulated" situation) than when it offers another *regulated* transmission service.[2] That evidence of record is not refuted by what, in the end, is the crux of Bell Atlantic's response—a single paragraph in its legal brief making bold economic assertions but devoid of citation to any evidence (BA Br. 23, second paragraph).[3] Bell Atlantic's error is starkly revealed in its concluding assertion: despite what Bell Atlantic says, a telephone company offering a *regulated* transmission service could *not* "simply charge unaffiliated

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[2] This point was elaborated in the principal materials that formed the background to the enactment of Section 533(b) by Congress in 1984—the 1981 FCC staff study and the 1982 Justice Department filings in the Bell breakup case. *See* NCTA Br. 8-12; *see also id.* at 10 n.8. Bell Atlantic's passing reference to what lay behind the *Commission*'s original action in *1970* (BA Br. 23), aside from being incomplete (*see* NCTA Br. 5-7), is a diversion.

[3] Although Bell Atlantic intimates otherwise (BA Br. 23, third paragraph), there is no dispute between NCTA and the Government on the only relevant proposition: that entry into cable retailing creates a distinctly new danger of monopoly abuse. And it is absurd to suggest (BA Br. 23, last paragraph) that this Court should find that full, direct control of a vertically integrated retail cable business provides no greater opportunities for economic abuse than offering a regulated facilities-rental service or owning 5% of the business.

In a related attempt to divert the Court's focus from the real issue, Bell Atlantic elsewhere twice makes the misleading and irrelevant assertion that Section 533(b) allows telephone company ownership of a "cable system," *i.e.*, of the physical plant. BA Br. 13-14, 43 n.45. But what is relevant for the economic dangers targeted by the statute, of course, is ownership of the cable *retail business*, *i.e.*, who controls the sale of the service to consumers. That is what Section 533(b) addresses, just as the broadcast-newspaper cross-ownership rule upheld in *NCCB* addresses a broadcaster's ownership of a newspaper business, not its ownership of a building that it might lease to a newspaper company.

video programmers monopoly rates for carriage" (BA Br. 24).[4]

2. *Regulatory Alternatives.* Because Section 533(b)'s presumptive bar on telephone entry into cable thus directly and materially advances the interest in preventing monopoly abuse by the local telephone companies, the real question is whether the Fourth Circuit could properly conclude that other regulatory means are available to advance that interest as effectively as Congress wished—a conclusion the Fourth Circuit drew even while explicitly assuming "that ordinary regulatory oversight is insufficient to guard against telephone company use of cross-subsidization." Pet. App. 39a. Bell Atlantic responds, not by focusing on some as-yet-untried regulatory mechanism for addressing the problem, but chiefly by pointing to existing regulations and asserting that this Court is legally required to find them effective because, Bell Atlantic says, the Government has declared them "effective." BA Br. 24-25, 25-27, 31-32. Section 533(b) cannot be judicially invalidated on this basis.

First, Bell Atlantic has mischaracterized what the Commission and other agencies of the Government have concluded. As the United States explained in its opening brief, the government agencies have concluded that their rules on cross-subsidy and discrimination have reduced

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[4] Both cross-subsidy and discrimination in access are forms of the economic abuse attacked by the presumptive cross-ownership bar. As to the latter, the bar serves to ensure non-discriminatory access by cable operators to needed space on telephone poles and also access by programmers to the telephone company's video network, taking away the natural incentive the telephone company has to use its control over access to favor its own programming. *See, e.g.*, US Br. 5, 36-37. Bell Atlantic responds only with the suggestion (BA Br. 28-29), implausible on its face, that there would be *more* outlets for independent programmers if Bell Atlantic can occupy its video capacity itself than if its capacity all had to be devoted to independent programmers. The suggestion is especially peculiar in light of Bell Atlantic's pointed insistence elsewhere in its brief, presumably rooted in practical plans, that it seeks to be able to build only enough capacity for itself. BA Br. 44.

but not eliminated the dangers and that, in *their* view, the reduced risk is now outweighed by the competitive benefits of telephone entry into cable. US Br. 32 n.21. That is not at all the same as concluding that the prevention of the targeted economic abuse would be achieved as effectively without Section 533(b). *Turner*, 114 S. Ct. at 2469. In other words, with respect to the *factual* aspect of "effectiveness," neither the FCC nor other executive agencies have concluded that regulatory checks are fully effective or, indeed, are substantially as effective as the structural bar of Section 533(b)(1) and (2); and with respect to the *value* question of how intolerable is the degree of ineffectiveness and hence the residual dangers of economic abuse (compared with possible benefits of entry), the policy view of executive agencies is not to be preferred to Congress's. *Cf. Sable Communications of Cal., Inc. v. FCC*, 492 U.S. 115, 131-32 (1989) (Scalia, J., concurring) (stressing that deciding how much regulatory ineffectiveness to tolerate is a value judgment; Court makes judgment in strict-scrutiny setting).

Second, the risks of unchecked cross-subsidy and discrimination, resistant to any plausible set of Commission regulatory efforts, are manifestly substantial. The record in this case, decisions by this Court and other courts, and scholarly literature all attest to both the intrinsic unreliability of allocations of common costs between regulated and unregulated enterprises and the persistent difficulty of trying to control cross-subsidy and discrimination in an industry as large, technologically complex, and changing as the telephone industry. *See* NCTA Br. 42-43 & n.37; *Permian Basin Area Rate Cases*, 390 U.S. 747, 804 (1968) (affirming judgment that apportionment of common costs between regulated and unregulated activities is "intrinsically unreliable"). No judicial decision cited by Bell Atlantic remotely touches this point. *See* BA Br. 25 (saying no more than that rules have been "tighten[ed]" or that risks are "significantly *reduced*") (emphasis

added).[5] And Bell Atlantic has essentially no response (*see* BA Br. 32) to the fact that twice in recent years (in 1987 and again in 1993) the General Accounting Office has concluded that cross-subsidy cannot be controlled without direct independent FCC audits and that audit levels are so grossly deficient that each local telephone company could expect to be audited once every 16 years. JA 120; *see* JA 79-101, 118-36. No realistic program of regulatory oversight could leave the risks of uncorrected economic abuse other than substantial.

Bell Atlantic, again departing from the Fourth Circuit, also points to changing forms of price regulation as somehow solving the monopoly-abuse problem. BA Br. 25-27. But Bell Atlantic must choose its words carefully to assert only that the "*traditional* link" between costs and rates has been widely broken, replaced by the different links between costs and rates allowed by varying forms of "price cap" plans. BA Br. 25 (emphasis added). Even Bell

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[5] Of the decisions cited by Bell Atlantic that affirmed various aspects of the Commission's rules as not "arbitrary and capricious" in various policy settings (BA Br. 25), none denies, or purports to deny, the existence of a substantial degree of *in*effectiveness of the regulatory solutions even in their own contexts. (In fact, several of the Commission's rules in this area have been held to fail even the highly deferential APA standard. *See California v. FCC*, 905 F.2d 1217 (9th Cir. 1990); *California v. FCC*, 39 F.3d 919 (9th Cir. 1994), *cert. denied*, 115 S. Ct. 1427 (1995).) Still less do they consider any of the special problems of telephone entry into cable, which involves (a) distinctly massive investments in new networks, (b) unique problems of access discrimination (because video capacity, unlike non-video capacity, will for a good while into the future be far less than demand, forcing choices among programmers), and (c) a unique threat of competition to the basic telephone business. Unsurprisingly, the Commission has noted that these new regulatory questions are far from settled, but remain open for future study and appropriate action: otherwise, the very existence of the current rulemaking proceeding would be inexplicable. *See Fourth Further Notice of Proposed Rulemaking*, 10 F.C.C.Rcd 4617, ¶¶ 18-41 (1995). As for the several decisions about Section 533(b) cited by Bell Atlantic (*see* BA Br. 25), the courts in those cases conducted no more detailed reviews of FCC regulations than the Fourth Circuit did in this case.

Atlantic does not suggest, and there would be no record basis to suggest, that "pure" price cap regulation has been generally adopted—or adopted anywhere at all, if "pure" is properly understood, in light of the relevant economic purposes, to mean a complete severing of any connection between costs and regulators' rules on current or future rates. To the contrary, the record makes clear that existing price cap plans *do* generally retain a connection between rates and costs, albeit a different form of connection than under classic forms of rate-of-return regulation. *See* JA 254, 262-64.[6] Nor is there any precedent for Bell Atlantic's apparent suggestion (BA Br. 26) that the government must sacrifice *other* wholly legitimate policy interests in order to minimize any impact on speech—here, the complex policies supporting the choice of retaining a

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[6] *See also Video Dialtone Reconsideration Order*, 10 F.C.C.Rcd 244, ¶ 154 (1994) ("The LEC price cap plan . . . retains a connection between total interstate costs and overall rate levels by means of sharing and lower end adjustment mechanisms."); J. Thorne, P. Huber, & M. Kellogg, *supra*, § 8.2, at 460 ("Existing forms of price-cap regulation are not pure; they provide for periodic adjustments based on costs.").

Bell Atlantic, in a footnote, makes the undocumented assertion, with respect to intrastate telephone rates, that 15 out of 51 jurisdictions now "have adopted pure price caps for intrastate services"; with respect to interstate rates, it refers to certain FCC regulatory developments that post-date the compilation of the record in this case. BA Br. 26 n.17. But Bell Atlantic's claims have no relevance here. Any factual developments that are not part of the record below, which necessarily have not been subject to any adversarial testing, may be grounds for reconsideration of the legal issues on a different record, but they are not properly considered in reviewing the district court's grant of summary judgment that is before this Court. *See, e.g., Catrett v. Johns-Manville Sales Corp.*, 826 F.2d 33, 37 (D.C. Cir. 1987) (per Starr, J.), *cert. denied*, 484 U.S. 1066 (1988); 10 C. Wright, A. Miller, & M. Kane, *Federal Practice and Procedure* § 2716, at 650-54 (2d ed. 1983). In any event, Bell Atlantic's unelaborated assertions embody a highly contentious, and in our view incorrect, view of what "pure" price cap regulation is: for example, the FCC plan that Bell Atlantic describes in fact allows for future adjustments based on costs. Of course, by Bell Atlantic's own figures, most States fail to meet even Bell Atlantic's standard for price caps.

cost basis for monopolists' rates (*see, e.g., Symposium on Price-Cap Regulation*, 20 Rand J. Econ. 369-472 (1989)). The narrow-tailoring component of intermediate scrutiny provides for judicial testing of the "fit" between the government measure and the governmental interest; it does not allow for the courts to force different policy choices by the government that sacrifice other legitimate interests.

Finally, Bell Atlantic seeks support for the assertion of regulatory adequacy (as a matter of law) in the D.C. Circuit's decision in *United States v. Western Elec. Co.*, 993 F.2d 1572, *cert. denied*, 114 S. Ct. 487 (1993), which affirmed a voluntary consent-decree modification to allow telephone entry into information services. BA Br. 30-31. But this reliance is badly misplaced, even aside from the facts that the telephone-cable setting presents uniquely grave risks of cross-subsidy and access discrimination (*see* note 5, *supra*) and that *reduction* of the risks was all that the Government asserted, as one factor in a complex policy balance (*see* 993 F.3d at 1578). Bell Atlantic has grossly misdescribed what the D.C. Circuit held. The court did not "endorse[]" the Government's determinations (BA Br. 30) or hold that any contrary findings " '[would have been] clearly erroneous' " (BA Br. 31). Rather, the D.C. Circuit repeatedly stressed, as Bell Atlantic itself urged (*see* NCTA Br. 43-44), that the judicial role on this complex policy question was limited to assessing the "reasonableness" of the Government's determinations—not the unreasonableness or even incorrectness of contrary views, which the court acknowledged might well be right—and held only and precisely that the district court had been "clearly erroneous *to the extent that it found the Department's conclusion unreasonable.*" 993 F.3d at 1578 (emphasis added); *see id.* at 1581, 1582. That deliberately limited conclusion furnishes no support for declaring regulatory oversight adequate as a matter of law to protect against the risks of monopoly abuse at the level of effectiveness that Congress, as a policy matter, is entitled to choose. Once the policy

choice is properly left to Congress, it is clear that Section 533(b)(1) and (2) do not "burden substantially more speech than is necessary to further the government's legitimate interests." *Ward v. Rock Against Racism*, 491 U.S. at 799.

3. *Alternative Avenues of Communication.* Bell Atlantic also contends that the presumptive cross-ownership bar "does not leave telephone companies with adequate alternatives for delivering their video speech." BA Br. 34; *see id.* at 34-36. This contention, like the Fourth Circuit's conclusion to the same effect, should be rejected because it rests on both factual and legal errors. The Fourth Circuit, notably, ignored some of the key avenues for speech now acknowledged by Bell Atlantic. The actual full range of alternatives left open to telephone companies like Bell Atlantic should be deemed adequate, and Section 533(b)(1) and (2) upheld as no more burdensome of speech than necessary to serve the important speech-neutral consumer-protection interests underlying the statute.

Section 533(b)(1) and (2), to begin with, leave open all non-video programming everywhere as well as all video programming outside the telephone-monopoly region, *i.e.*, in more than 85% of the country. For the remaining households within its telephone-monopoly region, Bell Atlantic is pointedly *not* excluded from the "most important medium of communication" (BA Br. 9), *i.e.*, "video programming" (JA 152, cited at BA Br. 9)—not even from multichannel video programming. Thus, one step removed from consumers, Bell Atlantic may, like any other independent program creator, create programs or packages of programs to sell to independent cable retailers, broadcasters, satellite services, or wireless cable services.[7] And Bell Atlantic also may provide its video

[7] As a practical matter, it is hard to imagine how Bell Atlantic, if it plans to offer programming popular enough that it would be genuinely competitive, would have any trouble finding a retailer desiring to purchase the programming. And although Bell Atlantic cites past problems with use of the leased access rights provided

programming *directly* to consumers in various ways, with no intervening editorial control: for example, it may become a broadcaster, a provider of direct broadcast satellite service (DBS), or (as it has) a provider of "wireless cable" service (MMDS). The last of those options, all by itself, is capable of reaching 75% of the in-region homes. BA Br. 36 n.29. The only avenue foreclosed by Section 533(b)(1) and (2) is the specific source of the economic problem for the telephone monopolist, in-region wire-delivered direct retailing of video programming.

The range of speech thus left open not only is very wide, but is legally "adequate" under the central governing precedent. Bell Atlantic argues that the foreclosure at issue here is no more defensible than "a law prohibiting the *Washington Post* from publishing a newspaper." BA Br. 11. But this Court in *FCC v. NCCB*, of course, unanimously held that the Washington Post Company *could* constitutionally be prohibited from publishing a newspaper in any community where it also ran a television station. And while Bell Atlantic tries to disregard *NCCB* (BA Br. 14 n.10), it is hard to imagine how a bar on participating in one aspect of the multichannel video programming business (on condition of giving up an activity that is not protected by the First Amendment, *i.e.*, telephone common carriage) could be any *more* problematic constitutionally than a bar on participating in the *newspaper* business (on condition of giving up an activity that *is* protected by the First Amendment, *i.e.*, broadcasting). The avenues of speech left open to Bell Atlantic are ample on their own terms and *a fortiori* adequate under *FCC v. NCCB*.

B. Under Applicable Precedent, Strict Scrutiny Does Not Apply to Section 533(b).

The Fourth Circuit rejected Bell Atlantic's argument for strict scrutiny. Pet. App. 20a-33a. Disagreeing with

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by 47 U.S.C. § 532 (*see* BA Br. 35 n.28), its own evidence indicates that the Commission has addressed the matter since the 1992 Cable Act. *See* JA 289-90.

the Fourth Circuit, and joined by no other court to have addressed the issue, Bell Atlantic seeks to resuscitate its grounds for strict scrutiny. BA Br. 12-18. Under applicable precedent, the claim to strict scrutiny is devoid of merit.

Bell Atlantic first argues for strict scrutiny based on the notion that Section 533(b) is a "direct ban on speech and nothing but speech." BA Br. 12. But as a factual matter, even aside from the waiver provision, Section 533(b) does not ban the telephone companies from speech, even from in-region video speech, as we have just discussed. In any event, none of the decisions cited by Bell Atlantic in support of this argument either invokes strict scrutiny or strikes down a measure under strict scrutiny, where the measure was justified on the basis of a speech-neutral government interest and not an interest in altering the content of speech. *See* BA Br. 12-13. Of course, a government measure may fail to pass intermediate scrutiny itself, on the merits, if it is simply too sweeping in its effects on speech, for it is then not a "reasonable" restriction on the time, place, or manner of speech.[8] This Court's precedents, however, do not supply a separate category of strict scrutiny for "direct bans." *See Members of City Council v. Taxpayers for Vincent*, 466 U.S. 789 (1984) ("direct ban" on signs upheld under intermediate scrutiny).

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[8] Aside from decisions involving explicitly content-based statutes (*Buckley v. Valeo*, 424 U.S. 1 (1976)) or unduly discretionary regimes struck down precisely because of the serious potential for content-based restrictions (*City of Lakewood v. Plain Dealer Pub. Co.*, 486 U.S. 750 (1988)) or restrictions of speech justified by no government interest at all except an interest in message alteration (*Hurley v. Irish-American Gay, Lesbian and Bisexual Group of Boston*, 115 S. Ct. 2338, 2350 (1995)), Bell Atlantic relies only on decisions that nowhere invoke strict scrutiny but, instead, seem to accept the "*reasonable* time, place, or manner" standard but then find, on the merits, that the standard was not met because the governmental restriction was too sweeping to be reasonable. *See Schad v. Borough of Mount Ephraim*, 452 U.S. 61, 74-76 (1981); *Martin v. City of Struthers*, 319 U.S. 141, 147 (1943); *City of Ladue v. Gilleo*, 114 S. Ct. 2038, 2046 (1994).

Bell Atlantic also argues that Section 533(b) is content-based. BA Br. 16-18. But, as the Fourth Circuit held, this contention is impossible to square with *Turner*, because Section 533(b) is in no way concerned with or addressed to the subject matter or message (much less viewpoint) of the speech; it is, rather, designed to serve speech-neutral economic interests, which, of course, require an "industry" or "business" definition. *See* BA Br. 20 (conceding that Section 533(b) is not aimed at any harm from the speech itself, but at economic problems). If the statute's use of "video programming" for that purpose renders it content-based, then the must-carry law at issue in *Turner*, and the entire Cable Act, are content-based, because "cable operators" and "cable service" are themselves defined in terms of "video programming." 47 U.S.C. § 522.[9] As long as *Turner* is good law, there is no argument for strict scrutiny here.

C. The Waiver Provision of Section 533(b)(4), Permissibly Construed to Narrow the Restrictions on Telephone Entry Into Cable, Eliminates Any Facial Constitutional Difficulty.

Bell Atlantic is not entitled to an affirmance of the Fourth Circuit's facial invalidation of Section 533(b) for another reason: the court of appeals' (and Bell Atlantic's) analysis focuses exclusively on the presumptive bar set forth in Section 533(b)(1) and (2) and utterly ignores the waiver authority set forth in Section 533(b)(4). In fact, the Commission has construed the waiver provision, in recognition of First Amendment concerns, to *allow* in-region telephone entry into cable, under regulatory standards that are themselves subject to constitutional requirements. Quite simply, if the entirety of Section 533(b) is suitably read, as the Commission has done, the premise

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[9] There is no realistic concern in this facial challenge that FCC discretion over line-drawing will be used to influence content: Bell Atlantic has not remotely shown that its programming, to be offered to compete with existing cable service, will come anywhere near any definitional line or require governmental judgments at all.

of the Fourth Circuit's ruling and of Bell Atlantic's attack—that the statute bans in-region entry—is eliminated. The statute before this Court is not the statute that the Fourth Circuit assumed or Bell Atlantic challenges.

Although Bell Atlantic makes a half-hearted attempt to suggest otherwise (BA Br. 39-40), the text of Section 533(b)(4) plainly is no less accommodating of a broad definition of "good cause"—broad enough to accomplish the very narrowing the Fourth Circuit called for—than the statutory texts construed in other decisions of this Court under the principle commanding avoidance of constitutional difficulties where possible. *See, e.g.*, NCTA Br. 26-27.[10] Given that principle, it would be perverse to declare that the avoidance of constitutional difficulties is anything other than "good cause," especially under Bell Atlantic's view that the statutory policy of fair competition would be served, rather than defeated, by telephone entry. The Commission's recent formal rulemaking makes clear that a broad "saving" construction of the Act is fully consistent with the statute. *See* Pet. App. 111a-120a.[11]

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[10] In Bell Atlantic's only reference to the text (BA Br. 40), it transforms a provision that actually refers to "particular" circumstances into one referring to "exceptional" circumstances and, in addition, treats the provision as a limit on FCC authority when it is actually a directive for mandatory waivers. *See* 47 U.S.C. § 533(b)(4). Bell Atlantic points to certain decisions involving other uses of "good cause" (BA Br. 40 n.37), but context surely plays a large role in determining the meaning of such a phrase, and constitutional concerns, wholly absent in the cited decisions, play an even larger role.

[11] Bell Atlantic protests that the new Commission construction is a change from prior constructions and is inconsistent with a prior D.C. Circuit decision. BA Br. 41, 40. But in addition to the fact that the departure from prior practice is overstated (*see* NCTA Br. 7-8), the Commission is of course fully entitled to alter its interpretation even aside from constitutional concerns (*e.g.*, *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 49, 57 (1983)), and both changed circumstances and newly presented constitutional issues can supply ample justification for a

Bell Atlantic, rather than welcoming the Commission's loosening of restrictions on its speech in light of Bell Atlantic's asserted First Amendment interests, instead attacks the Commission's construction as the equivalent of a defendant's "voluntary cessation" of challenged activity, which sometimes fails to moot a case. BA Br. 37-39. But even on its own terms the analogy is unhelpful, because Bell Atlantic cannot seriously contend, in light of the Commission's policy analysis and commitments, that this case presents one of the " 'exceptional situations' " where there is a " 'reasonable expectation' " of a return to the earlier legal position. *Lewis v. Continental Bank Corp.*, 494 U.S. 472, 481 (1990). In any event, the mootness analogy is beside the point, because the relevance of the Commission rulemaking is not to suggest mootness but instead to demonstrate that, if constitutional difficulties are found in Section 533(b)(1) and (2), the statute is capable of being construed to avoid them—through a flexible reading of Section 533(b)(4). The Commission's rulemaking shows that this is more than possible.

Bell Atlantic argues that the saving construction of the statute must be rejected because a flexible reading of Section 533(b)(4) vests too much discretion in the Commission and because the Commission has not yet defined the conditions for telephone companies' speech on their own joint voice-video networks. BA Br. 42-45. But, even aside from the fact that the Commission's construction unmistakably does allow in-region video programming by the telephone companies, the only real question in determining the facial validity of the statute is whether the Commission *could* adopt constitutional, discretion-limiting rules defining the reach of the waiver authority: this Court has

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change. As for the relied-on D.C. Circuit decision, Bell Atlantic has patently overread the court's holding; the case involved no constitutional argument; and the decision is hardly binding on this Court. *See* NCTA Br. 34 (discussing decision); Pet. App. 120a-121a.

made clear, in the very precedent that Bell Atlantic cites, that discretion in administration may be properly limited, for First Amendment purposes, by "binding judicial or administrative construction, or well-established practice." *City of Lakewood*, 486 U.S. at 770. Bell Atlantic may, of course, challenge the adequacy of the Commission's rules (on First Amendment or other grounds) or even the dispatch with which the Commission adopts them.[12] But Bell Atlantic is distinctly ill-situated to make any challenge to the present adequacy of the Commission's detailed standards for telephone companies' provision of programming on their own networks: together with other local telephone companies, Bell Atlantic this summer specifically asked the Commission to delay its announcement of the new regulatory standards that were on the Commission's agenda for action. *See* "Bell Atlantic Campaigns Against Dual Regulation," *Washington Post*, July 20, 1995, at D9 (proposing delay); "USTA Asks for Delay," *Communications Daily*, July 19, 1995, at 3 (same). In sum, Section 533(b)(4) remains available, if properly construed and implemented, to "save" the statute from any constitutional problems.

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[12] Challenges to Commission action may not be brought in district court, but are within the exclusive jurisdiction of the courts of appeals. 47 U.S.C. § 402(a); 28 U.S.C. § 2342; *FCC v. ITT World Communications, Inc.*, 466 U.S. 463, 468 (1984); *National Broadcasting Co. v. United States*, 319 U.S. 190 (1943). Of course, if Bell Atlantic believes that the formulation of new discretion-limiting rules has been "unreasonably delayed," it may seek review on that basis. 5 U.S.C. § 706(1); *Telecommunications Research & Action Center v. FCC*, 750 F.2d 70, 76-81 (D.C. Cir. 1984).

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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BELL ATLANTIC CORPORATION, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF *AMICUS CURIAE* OF THE CALIFORNIA CABLE TELEVISION ASSOCIATION IN SUPPORT OF PETITIONERS

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BRIEF *AMICUS CURIAE* OF THE CALIFORNIA CABLE TELEVISION ASSOCIATION IN SUPPORT OF PETITIONERS

INTEREST OF *AMICUS CURIAE*

The California Cable Television Association ("CCTA") submits this brief as *amicus curiae* in support of petitioners.[1]

CCTA is a trade association representing cable television system operators that provide cable television service to nearly six million California residents, as well

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[1] Consistent with S. Ct. R. 37.3, all parties have given CCTA their consent to the filing of this brief. Two members of CCTA, Time Warner Cable and Home Box Office, are not represented by CCTA for purposes of this action.

as cable television programmers and equipment suppliers. CCTA brings information to the Court concerning the effect elimination of the in-region ban on telephone company provision of video programming has had, and will continue to have, on cable television operators and consumers in California. CCTA has unique knowledge of the incentive and ability of local exchange carriers ("LECs") in California—specifically, Pacific Bell ("Pacific") and GTE Corporation—to engage in anticompetitive behavior in a manner that directly affects the ability of cable operators to compete effectively in the marketplace. Notably, this anticompetitive conduct is at the heart of the congressional justification for Section 533(b) of the Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2779, 47 U.S.C. § 533(b) ("telephone-cable cross-ownership ban" or "cross-ownership ban").

Since 1958, CCTA has participated in proceedings before administrative, legislative, and judicial bodies on behalf of the cable television industry in California and its individual members. CCTA has a wide range of experience advocating the rights of cable television operators before this Court [2] and before the United States Court of Appeals for the Ninth Circuit.[3] Most recent and relevant to the questions posed by the petitioners, CCTA filed a brief as intervenor-applicant in the United States Court of Appeals for the Ninth Circuit when the district

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[2] See *amicus* briefs filed by CCTA in *Turner Broadcasting System, Inc. v. FCC*, 114 S. Ct. 2445 (1994) and *Leathers v. Medlock*, 499 U.S. 439 (1991).

[3] CCTA has filed *amicus* briefs in *Preferred Communications, Inc. v. City of Los Angeles, California, and Department of Water and Power*, 754 F.2d 1396 (9th Cir. 1985), aff'd, 476 U.S. 488 (1986); and *Preferred Communications, Inc. v. City of Los Angeles, California, and Department of Water and Power*, 13 F.3d 1327 (9th Cir.), cert. denied, 114 S. Ct. 2738 (1994).

court invalidated the telephone company-cable operator cross-ownership ban at issue in this case.[4]

This *amicus* brief will illustrate that resolution of the issues raised by petitioners before this Court will have a substantial impact on competition in the provision of multichannel video programming, the video services market, and the market for local telephone competition as well.

SUMMARY OF ARGUMENT

The telephone-cable cross-ownership ban is an economic regulation that was enacted by Congress for the purpose of preserving and increasing competition in the video services business. There is no doubt that the provision serves this important governmental purpose. CCTA has observed telephone companies in California for more than three decades and has documented numerous cases of illegal cross-subsidization and discriminatory acts. The incentive and ability to engage in these types of anticompetitive behavior is increasing as telephone companies enter the video business and as competitors to their telephone monopolies are just beginning to appear on the distant horizon. Congress could reasonably have determined that a ban on telephone company provison of video programming within their telephone service area is the only effective means to protect the cable industry from these abuses.

At the same time, the cross-ownership ban does not implicate the First Amendment rights of telephone companies in any meaningful way. The courts below cor-

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[4] See Brief of CCTA in *U S West, Inc. v. United States*, 48 F.3d 1092 (9th Cir. 1995), petition for reh'g pending. The court of appeals ultimately denied CCTA intervenor status in that case and, thus, CCTA participated as *amicus curiae*. CCTA, however, participated in joint oral argument of the *U S West* case in its capacity as an intervenor in *Pacific Telesis Group v. United States*, 48 F.3d 1106 (9th Cir. 1994), petition for reh'g pending, which also involved a constitutional challenge to Section 533(b). In addition, CCTA was a party in *GTE California, Inc. v. FCC*, 39 F.3d 940 (9th Cir. 1994).

rectly determined that the prohibition on providing video programming directly to subscribers within their service areas leaves open ample alternative opportunities for communication. While there may be some room for debate regarding to the appropriateness of Section 533(b) as a policy matter, the dispute does not rise to a constitutional level. This Court should leave intact the long-standing congressional determination on this purely economic issue and permit the policy questions involved to be resolved by Congress.

ARGUMENT

This case is about whether Congress has the authority to enact a non-content based regulation as a means to increase media outlet diversity and deter anticompetitive behavior if such regulation has an incidental (and minor) effect on the speech rights of telephone companies. CCTA submits that, given the wide array of alternative avenues for communication available to telephone companies and the fact that the regulation serves an important governmental purpose, Congress' decision to restrict telephone company-cable television cross-ownership is entirely consistent with the First Amendment.

"[T]he First Amendment does not guarantee the right to communicate one's views at all times and places or in any manner that may be desired." [5] At most, Section 533(b) operates as a time, place and manner regulation: it merely limits the manner (no provision of video programming directly to subscribers) in which a telephone company may speak in certain places (its local telephone service areas). Under the standards applicable to such circumstances,[6] Section 533(b) is constitutional.

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[5] *Heffron v. International Society for Krishna Consciousness, Inc.*, 452 U.S. 640, 647 (1981).

[6] See *Turner Broadcasting System, Inc. v. FCC*, 114 S. Ct. 2445 (1994); *Ward v. Rock Against Racism*, 491 U.S. 781 (1989); *United States v. O'Brien*, 391 U.S. 367 (1968).

Congress had good reason to restrict local telephone companies from providing cable television service in their telephone service areas when it enacted Section 533(b) in 1984, and those justifications are equally relevant and constitutionally valid today. The concerns that lay at the heart of Congress' action involved the telephone companies' ability to thwart competition by shifting costs from the competitive video business to their captive telephone ratepayers. Congress also recognized that cable operators' reliance on access to telephone poles and conduits to distribute their signals raised significant discrimination issues.

In California, the local telephone business is a monopoly with almost $11 billion in annual revenues.[7] By comparison, CCTA's cable operator members have approximately $3 billion in annual revenues in California spread among eight large and several dozen small companies with local franchises that are non-exclusive. Section 533(b) ensures the continued viability of the cable television industry given the current level of telephone company cross-subsidy and discriminatory acts.

I. SECTION 533(b) IS A REASONABLE CROSS-OWNERSHIP PROVISION THAT SERVES A SIGNIFICANT GOVERNMENTAL PURPOSE

A. By prohibiting telephone companies from providing video programming that they own and control to customers within their telephone service areas, Section 533(b) does not take a unique regulatory approach in the communications area. Rather, it is but one of a series of provisions that place limits on who can participate in various segments of the industry.

For example, Section 533(a)(1) restricts broadcast television stations from owning cable television systems within their signal areas. Similarly, Section 533(a)(2)

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[7] See Federal-State Joint Board Staff, Comprehensive Monitoring Report on Telephone Service, CC Docket No. 87-339, at 447 (May 1995).

prevents cable operators from holding licenses for "wireless" cable systems or operating satellite master antenna systems within their cable service areas.

Federal Communications Commission ("FCC") regulations also prohibit common ownership of cable facilities and broadcast television networks, 47 C.F.R. § 76.501 (b)(1) (1994), daily newspapers and broadcast stations in the same community, *id.* at § 73.3555(d), and a common interest in two television stations with overlapping service areas or in a radio and television station in the same market, *id.* at § 73.3555(c).

B. The statutory provisions and regulations were designed to increase media outlet diversity and prevent anticompetitive behavior. The cable television-telephone company prohibition, for example, was first adopted by the FCC in 1970 to address the problem of discrimination against cable companies unaffiliated with LECs and to avoid the extension of the telephone company monopoly into the cable services market.[8] The FCC concluded that "the preservation of . . . competition will best be assured by the exclusion of telephone companies in their service areas from engaging in the sale of [cable] service to the viewing public."[9]

Following a decade of experience with the telephone-cable cross-ownership provision, in 1980, the FCC directed its staff to conduct a study of the Commission's cable cross-ownership policies. This directive culminated in the issuance of a 200-page report by the FCC Office of Plans and Policy in November 1981, shortly before

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[8] See 47 C.F.R. § 63.54 (1994) (originally codified at 47 C.F.R. § 64.601 (1971)); *Applications of Telephone Companies for Section 214 Certificates for Channel Facilities Furnished to Affiliated Community Antenna Television Systems*, 21 F.C.C.2d 307 (1970), aff'd *sub nom. General Tel. Co. of Southwest v. United States*, 449 F.2d 846 (5th Cir. 1971).

[9] 21 F.C.C.2d at 325.

Congress began considering legislation that would evolve into the 1984 Cable Act.[10]

After considering in detail a number of alternative regulatory policies, the *1981 OPP Report* concluded that continued prohibition of telephone-cable cross-ownership "remains essential." [11] Among the other things, the report explained that entry into the local cable television business may "allow a telephone company partially to avoid rate-of-return regulation on its telephone service" by "attributing costs to the regulated telephone division and revenues to an unregulated cable division." [12]

But perhaps more importantly, the report went beyond the original justifications for the rule and concluded that the cross-ownership restriction should not be lifted until the potential of cable television operators to become genuine competitors of telephone companies with respect to local *telephone* services became more clear. The report noted that "cable has more potential to provide telephone-like services in the near future than does any other carrier." [13] Independent cable operators thus offered the potential "to constrain telephone company market power" and "long run prospects for eliminating the 'local bottleneck' altogether." *Id.* at 160. Thus, the Commission ex-

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[10] FCC Office of Plans and Policy, *FCC Policy on Cable Ownership: A Staff Report* (Nov. 1981) (*"1981 OPP Report"*).

[11] *Id.* at 177. See also *id.* at 143 (restriction "must be retained for the time being.").

[12] *Id.* at 153. See *California v. FCC*, 905 F.2d 1217, 1224 (9th Cir. 1990) (explaining in a related context that "[s]uch improper cost-shifting effectively subsidizes a carrier's unregulated activities with monopoly profits from its regulated activities, to the detriment of both its monopoly ratepayers and its competitors in the [unregulated] market.").

[13] *1981 OPP Report* at 159. See also *id.* at 176 ("Indeed, cable now shows greater promise for becoming a competitor in many two-way services than ever before. Therefore, the ban should be continued.").

plained, the decision of whether to lift the cross-ownership ban:

> *depends critically on the nature of competition in the provision of local loop services.* Cable facilities are currently one of a very few ways that the telephone company owned local loop can be circumvented. As such, unregulated cable ownership provides an important opportunity for continuing telephone company control over local distribution.

Id. at 177 (emphasis supplied).

C. Against this backdrop, Congress essentially codified the FCC's cross-ownership rules in Section 533(b) of the Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2779, 47 U.S.C. § 533(b). It indicated that the ban was intended "to prevent the development of local media monopolies, and to encourage a diversity of ownership of communications outlets." [14]

In recent years, Congress has studied and reassessed the policies underlying the telephone-cable cross-ownership ban on a nearly continuous basis and has chosen to retain the provision. In 1990, after the FCC had tentatively recommended repeal of the Section 533(b),[15] the Senate Commerce Committee issued a report stating that "[t]he Committee examined carefully the arguments of proponents and opponents of repeal of the cable/telco cross-ownership statute, and concluded that the Committee *could not* at the present time support repeal." [16] Moreover, in passing comprehensive cable television legislation in 1992, Congress reaffirmed its support of the telephone-cable cross-ownership provision and enacted

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[14] H.R. Rep. No. 934, 98th Cong., 2d Sess. 56 (1984).

[15] *In re Telephone Company—Cable Television Cross-Ownership Rules (Further Notice of Inquiry and Notice of Proposed Rulemaking)*, 3 FCC Rcd. 5849 (1988).

[16] S. Rep. No. 456, 101st Cong., 2d Sess. 8 (1990) (emphasis supplied).

additional cross-ownership rules governing the cable industry (also codified at 47 U.S.C. § 533).[17]

As the foregoing demonstrates, Congress reasonably concluded that enacting Section 533(b) would prevent telephone companies from improperly leveraging their state-sanctioned local telephone monopolies into an important adjacent market. More significantly, each time Congress had the opportunity after enactment of the telephone-cable cross-ownership ban to reconsider the provision, it chose to maintain the status quo. Even the court of appeals found that the restriction does indeed serve the significant governmental interest in media outlet diversity and deterrence of anticompetitive behavior.[18] This Court should uphold the long-standing congressional consensus on this issue.[19]

II. SECTION 533(b) IS NARROWLY TAILORED TO SERVE ITS OBJECTIVE OF PREVENTING MONOPOLY LEVERAGING AND PROMOTING FACILITIES-BASED COMPETITION

A. Under the *O'Brien-Ward* test, "the requirement of narrow tailoring is satisfied 'so long as the . . . regulation promotes a substantial government interest that would be achieved less effectively absent the regulation.' "[20] While the government may not regulate speech in such a manner that "a substantial portion of the burden on speech does not serve to advance its goals," the validity

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[17] See Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (1992) ("1992 Cable Act"); S. Rep. No. 92, 102d Cong., 2d Sess. 46-47 (1991) (accompanying the 1992 Cable Act), *reprinted in* 1992 U.S.C.C.A.N. 1133, 1179-80 ("1991 Senate Report").

[18] Pet. App. 34a.

[19] See *United States v. X-Citement Video, Inc.*, 115 S. Ct. 464, 467, 472 (1994).

[20] *Ward*, 491 U.S. at 800, quoting *United States v. Albertini*, 472 U.S. 675, 689 (1985); *Turner*, 114 S. Ct. at 2469.

of a content-neutral regulation " 'does not turn on a judge's agreement with the responsible decisionmaker[s] concerning the most appropriate method for promoting significant governmental interests' or the degree to which those interests should be promoted." [21] Rather, the *O'Brien* "tailoring" requirement is satisfied if the restriction on speech is "not broader than *Congress* reasonably could have determined to be necessary." [22]

In view of these governing standards, no basis exists in this case for casting aside the means Congress has selected to serve its unquestionably legitimate ends. *First*, on its face the statute is tailored *precisely* to its goal of preventing telephone companies from entering the cable television business by means of unfairly leveraging their local telephone monopolies. It does not apply where a telephone company possesses no such monopoly. The scope of the "burden on speech" corresponds directly to the evils Congress has sought to address.

Second, Congress could reasonably conclude that nonstructural regulatory "safeguards" would be inadequate—or, certainly, less effective—in furthering its economic objectives, and that a structural solution best serves its overall goals. As the General Accounting Office has cautioned, there is "considerable room for debate over what safeguards would be effective and/or adequate." [23]

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[21] *Ward*, 491 U.S. at 800, quoting *Albertini*, 472 U.S. at 689. See also *United States v. Edge Broadcasting Co.*, 113 S. Ct. 2696, 2705 (1993).

[22] *San Francisco Arts & Athletics, Inc. v. U.S. Olympic Comm.*, 483 U.S. 522, 539 (1987) (emphasis supplied).

[23] GAO, *Telephone Communications: Controlling Cross-Subsidy Between Regulated and Competitive Service* 11 (1987). See B. Owen & S. Wildman, *Video Economics* 256 (Harvard Univ. Press 1992) (noting that while "there are short-run advantages for the public" that would result from local telephone company entry in the cable business, competition between telephone and cable companies is "likely to be short lived, ending in a monopoly by the telephone company, whether or not economically justified.").

The FCC itself has recognized that "telephone companies continue to have the ability to deny potential competitors access [and] to engage in anticompetitive cross subsidies." [24]

Nonetheless, in tentatively concluding that "the costs of the cross-ownership ban exceed the benefits," the FCC stated that "safeguards perhaps analogous to those devised in *Computer III*" could be devised to address concerns regarding cross-subsidization and related anticompetitive conduct.[25] Subsequently, the Commission's rules in *Computer III*—particularly their reliance on nonstructual safeguards to prevent monopoly leveraging—were set aside as "arbitrary and capricious." [26] If the court of appeals could reach this conclusion despite the ordinary deference granted to administrative agencies, certainly Congress—which owes no such deference—reasonably could as well with respect to these types of issues.[27] In addition, Congress could reasonably conclude

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[24] *In re Telephone Company—Cable Television Cross-Ownership Rules (Further Notice of Inquiry and Notice of Proposed Rulemaking)*, 3 FCC Rcd. at 5860.

[25] *Id.* at 5856, 5860. *"Computer III"* refers to a proceeding in which the FCC issued rules governing the provision by the Bell Operating Companies of so-called "enhanced" or data processing services over their networks. See *California v. FCC*, 905 F.2d at 1223 & n.1-3.

[26] *California v. FCC*, 905 F.2d at 1238 ("the record yields no support for the Commission's position that market and technological changes . . . have reduced the danger of cross-subsidization by the [telephone companies].").

[27] As aptly stated by Commissioner Marshall, who joined the FCC's 1992 recommendation for repeal of Section 533(b), the Commission's position rests on certain "critical articles of faith," one being "that our cost accounting and open network architecture requirements will adequately police against cross-subsidization." *Telephone Company—Cable Television Cross-Ownership Rule, Sections 63.54-63.58, Second Report and Order, Recommendation to Congress and Second Further Notice of Proposed Rulemaking*, 7 FCC Rcd. 5781, 5881 (1992) (separate statement of Commissioner

that *other* advantages that flow from the historic and ongoing control of the local telephone monopoly—such as a guaranteed rate base and access to subscribers—justify restricting local telephone company entry into the cable television business as a matter of fair competition.

B. Nevertheless, the court of appeals found that the restriction is not narrowly tailored enough to pass constitutional muster because there exist less burdensome alternatives. The only alternative suggested by the court, however, is adoption of rules limiting "the telephone companies' editorial control over video programming to a fixed percentage of the channels' available." [28] The court did not explain how this alternative could adequately serve the government's objectives.

It could not. The key factual predicate that prompted promulgation of the ownership ban in the first instance still exists today. LECs continue to enjoy overwhelming dominance of the local telephone access market.[29] Nation-

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Marshall), modified in part on reconsideration, 10 FCC Rcd. 244 (1994).

[28] Pet. App. 41a.

[29] Until last month in California, local exchange carriers retained a *de jure* monopoly. See *In the Matter of Alternative Regulatory Frameworks for Local Exchange Carriers*, CAL. PUB. UTIL. Decision No. 89-10-031. Under interim rules adopted by the California Public Utilities Commission ("CPUC") on July 25, 1995, new entrants will now be able to apply to compete in the local telephone market. The CPUC may approve such applications to permit local exchange facilities-based competition to begin on January 1, 1996 and resale-based competition to begin on March 1, 1996. See *Order Instituting Rulemaking on the Commission's Own Motion into Competition for Local Exchange Service*, CAL. PUB. UTIL. Decision No. 95-07-054 (1995). The CPUC continues to work on significant aspects of the rules so that they can be implemented effectively in that time period. *Id.* Recent experience, however, demonstrates that California telephone companies, which have discriminated against toll call competitive entrants, would use all possible means to protect their *de facto* monopoly. See n.38, *infra*.

wide, industry analysts reported last year that aggregate revenues for access services of all competitive local telephone access providers combined are less than one percent of total monopoly LEC access revenues and an even smaller percentage of total revenues.[30] In 1994, the Pacific Telesis Group experienced a 2.9 percent increase in the number of customer access lines and a 7.7 percent jump in related minutes-of-use on its network.[31]

C. *Cross-Subsidy.* CCTA has had first-hand experience with telephone company attempts to exploit their extraordinary market power to gain a competitive advantage in the video services market. For example, in 1986, Pacific constructed a "leaseback" video transport cable system for an independent cable operator in Palo Alto, California, and estimated that the system's annual revenue for the first 15 years would recover its costs and yield a rate of return on Pacific's investment of between 10 and 12.72 percent.[32] Although Pacific's construction costs, in fact, had vastly exceeded its estimate, the company never increased its tariffed rates to the customer.[33] As a result, consumers and potential competitors were injured when Pacific required telephone ratepayers to bear the burden of its loss. Significantly, this conduct, which violated Pacific's tariff and the FCC's cross-ownership rules, was not prevented by the accounting "safeguards" imposed by the FCC.

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[30] Economics and Technology, Inc./Hatfield Associates, Inc., "The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers," at ii (February, 1994).

[31] Pacific Telesis Group, 1994 Summary Annual Report 2 (1995).

[32] Application of the Pacific Bell for Authority Pursuant to Section 214 of the Communications Act of 1934, and Section 63.01 of the Commission's Rules and Regulations to Construct and Maintain Broadband Cable Distribution Facilities in and around the City of Palo Alto, CA, File No. W-P-C 5753 (filed April, 1986 and amended September, 1986).

[33] See Reply of the California Cable Television Association to Pacific Bell's Opposition to Petitions to Deny, FCC File Nos. W-P-C 6913, 6914, 6915 and 6916, at 39-42 (filed March 11, 1994).

In June 1994, the National Association of Regulatory Utility Commissioners ("NARUC") confirmed, after performing a comprehensive audit, that Pacific has engaged in persistent cross-subsidization since 1990.[34] The NARUC audit team found that Pacific had failed to report and track many costs associated with research and development for its new broadband services, which are required to support high quality entertainment television.[35] More significantly, NARUC observed that the company had spent hundreds of millions of dollars on fiber-based applications that are competitively motivated without an evaluation of ratepayer benefits from their investments, which were charged to monoply services.[36] The results of this audit demonstrate that neither the state's "price-caps" regulation nor its cost allocation rules can prevent Pacific from proceeding with its investment plans secure in the belief that monoply ratepayers will pay for its unregulated network modifications.

D. *Discrimination.* One of the main purposes for enactment of the telephone-cable cross-ownership ban was to prevent telephone companies from using their ownership of poles to discriminate against cable television companies. Despite this safeguard, LECs continue to engage in anticompetitive behavior relative to pole attachment. Last month the CPUC warned Pacific to cease moving television cables into areas violating agency clearance rules in order to make room for its own broadband circuit system, which will transmit Pacific's video service.[37]

Moreover, as competition for telephony service begins to open, the telephone companies continue to use their

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[34] National Ass'n of Regulatory Utility Commissioners, *An Audit of the Affiliate Interests of the Pacific Telesis Group*, July 1994.

[35] *Id.* at B-49.

[36] *Id.* at B-50.

[37] See, *e.g.*, Letter from Harry Strahl, Acting Chief, Utilities Safety Branch, California Public Utilities Commission, to Mary Vanderpan, Regulatory Vice President, Pacific Bell, File No. G.O. 95/3069, dated July 10, 1995.

bottleneck to disadvantage new competitors. The CPUC recently concluded that Pacific is in violation of its own intrastate tariffs for refusing to route the toll calls of certain customers to competing carriers.[38] The CPUC issued a preliminary injunction against Pacific, finding that the complainant was likely to prevail on the merits of its claim that "Pacific is using its market power in the local exchange market to maintain a monopoly in the market for intraLATA toll service." [39]

LECs have engaged in similar tactics in an effort to circumvent the FCC's attempts to increase competition in the local telephone markets. After months of litigation and stalling on the part of the telephone companies, the FCC concluded in May 1995 that a number of LECs had offered virtual collocation rates to competitive access providers that were unlawfully high.[40] While the FCC prescribed significantly lower maximum rates, the telephone companies' action had the effect of delaying the commencement of local access competition.

E. It is far from clear whether the FCC has the practical ability to police LEC anticompetitive behavior in the form of cross-subsidy and discrimination. For example, the agency recently granted Pacific's applications to construct and operate "common carrier" video dialtone systems in California, despite the telephone company's proposal to charge 78 percent of the costs associated with constructing its new integrated hybrid fiber-coaxial system to its telephone ratepayers.[41] While

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[38] *MCI Telecommunications Corp. v. Pacific Bell*, No. 95-05-020, 1995 Cal. PUC LEXIS 458 (May 10, 1995).

[39] *Id.* at *59.

[40] *In the Matter of Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection Through Virtual Collocation for Special Access and Switched Transport*, CC Docket No. 94-97, Phase I (released May 11, 1995).

[41] See *In the Matter of the Applications of Pacific Bell for Authority pursuant to Section 214 of the Communications Act of 1934, as amended, to construct, operate, own, and maintain advanced*

the FCC recognized that Pacific's applications formed part of the company's overall plans to deploy an advanced broadband network that will provide both telephone and video services over the same transmission path to a projected five million homes by the end of the decade,[42] it has not yet resolved fundamental questions regarding cost allocation between the regulated and unregulated aspects of the network.

The serious threat of cross-subsidization represented by this void in agency regulation prompted FCC Commissioner Andrew Barrett to urge the FCC to resolve in the near term the "very important and yet unanswered cost allocation issues" associated with video dialtone service.[43] Commissioner Barrett stated that the FCC's practice of waiting until the tariff review process to make such decisions has, in at least one case, allowed rates to remain in effect, "which have the potential of being predatorily low." [44]

This overwhelming evidence demonstrates that the cross-ownership ban was enacted and retained by Congress for

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fiber optic facilities and equipment to provide video dialtone service to selected communities in Orange County, the Southern San Francisco Bay Area, the Los Angeles area, and the San Diego area in California, FCC 95-302, File Nos. W-P-C 6913, 6914, 6915, 6916, Order and Authorization (released Aug. 15, 1995) (*"Pacific Authorization"*); see also Letter from Jeffrey Sinsheimer, Director of Regulatory Affairs, CCTA, to Kathleen M.H. Wallman, Chief, Common Carrier Bureau, FCC, Exhibit 1 at 2 (Declaration of Leland L. Johnson, Ph.D.), dated April 11, 1995.

[42] *Pacific Authorization*, at ¶ 7. The FCC also "overlooked" Pacific's proposal to grant discriminatory access to a "favored" video programmer and to purchase such programmer if this Court lifts the cross-ownership ban. See Letter from Spencer Kaitz, President, CCTA, to Reed Hundt, Chairman, FCC, FCC File Nos. W-P-C 6913, 6914, 6915, 6916, dated September 19, 1994.

[43] *Pacific Authorization*, Concurring Statement of Commissioner Andrew C. Barrett.

[44] *Id.*

a very important reason. It is the only measure that has the ability to prevent LECs from extending their telephone monopolies into the video services market. There are no less burdensome alternatives that would be sufficiently effective.

F. Equally important, there is simply no evidence that this statutory provision has any effect whatsoever on the ability of LECs to get their desired messages to local subscribers. As the district court in the case below recognized, "the statute leaves open ample alternative channels for communication." The court explained:

> Plaintiffs may provide video programming to audiences outside their service area, and may speak through any type of non-video medium to audiences inside their service area. Even more significantly, however, plaintiffs may also reach audiences within their service area with video programming. Section 533(b) only prohibits plaintiffs from *directly* providing video programming to their subscribers. Plaintiffs are not prohibited from producing their own video programming and marketing it to broadcasters or cable operators for transmission by means other than plaintiffs' own facilities. Public access requirements [see 47 U.S.C. § 532] ensure that such programming cannot be silenced by the entities responsible for the direct provision of the video programming.[45]

Section 533(b) does not "ban" *any* speech, the court found, but operates "only as a restriction on the 'manner' in which plaintiffs may speak." Thus, this very narrow economic regulation does not implicate the First Amendment in any meaningful way.

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[45] Pet. App. 71a.

CONCLUSION

For the foregoing reasons, the Court should find that Section 533(b) is consistent with the First Amendment and reverse the court of appeals.[46]

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[46] In the alternative to this Court's review, CCTA supports petitioners' request that the decision of the court of appeals be vacated and remanded for further consideration in light of the FCC's action in *Telephone Company—Cable Television Cross-Ownership Rule, Sections 63.54-63.58, Third Report and Order*, FCC 95-203 (released May 16, 1995).

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IN THE

Supreme Court of the United States
OCTOBER TERM, 1995

UNITED STATES OF AMERICA, *et al.*,
PETITIONERS,

v.

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA, *et al.*,
RESPONDENTS.

NATIONAL CABLE TELEVISION ASSOCIATION, INC.
PETITIONER,

v.

BELL ATLANTIC CORPORATION, *et al.*,
RESPONDENTS.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR AMICI CURIAE CONSUMER FEDERATION OF AMERICA AND VIRGINIA CITIZENS CONSUMER COUNCIL

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BRIEF FOR *AMICI CURIAE* CONSUMER FEDERATION OF AMERICA AND VIRGINIA CITIZENS CONSUMER COUNCIL

INTEREST OF THE *AMICI CURIAE*

Consumer Federation of America (CFA) and Virginia Citizens Consumer Council (VCCC) submit this brief as *amici curiae* in support of Appellants United States of America and the National Cable Television Association.

CFA is the nation's largest consumer advocacy group, representing more than 50 million individual members from among 240 national, state and local affiliates representing consumer, senior citizen, low income, labor, farm, public power and cooperative organizations. CFA has a longstanding interest in communications

policy issues. Its members' interests include, but go far beyond, the prices which small and residential customers pay for telecommunications services. CFA seeks to promote its members' access to information essential to their participation in the civic discourse which is at the heart of democratic self-governance. In this connection, it has advocated policies designed to ensure that all Americans have access to an affordable, state-of-the-art communications infrastructure to meet personal, educational, commercial and other national policy needs.

CFA has also participated in scores of federal and state proceedings addressing telecommunications policy issues, including proceedings before state utility commissions and the Federal Communications Commission ("FCC" or "Commission") affecting rates charged to consumers and access to basic telecommunications services. As an active party in FCC proceedings involving the prohibition of provision of video programming by telephone companies within their local exchange service areas (the subject of this litigation), CFA opposed the FCC's recommendation to Congress that it repeal these provisions, and took issue with some aspects of the "video dialtone" ("VDT") regulatory regime as devised by the FCC. CFA has long fought vertical integration in mass media and common carrier telecommunications services, including attempts of the Regional Bell Operating Companies ("RBOCs") and other monopoly telephone providers to integrate vertically into competitive markets at the expense of competition in those markets.

VCCC is a nonprofit, volunteer membership consumer advocacy organization that has represented consumer interests in Virginia since 1966. Its membership totals approximately 300 individuals and organizations. VCCC supports consumer protection legislation in the Virginia General Assembly and in Congress, participates in State Corporation Commission proceedings on utility, telephone, financial services and insurance issues, and provides information to its members and to the public on consumer issues and market surveys. VCCC has been significantly involved for several years in the development of telecommunications policy, both at the state and Federal levels, and is a leading advocate for telephone consumers in Virginia.

CFA and VCCC are filing this brief to set forth the interests and rights of members of the public - as speakers, as recipients of information and as customers. They believe that the telco/cable cross-ownership ban is a sound structural regulation that is narrowly tailored to meet the compelling governmental interest of ensuring diversity of voices and competition in the telecommunications and cable markets. There is not now, nor does it appear that there will be in the future, any viable and realistic alternative to this prohibition that can protect diversity and competition in the marketplace of services, or the marketplace of ideas.

SUMMARY OF ARGUMENT

The Circuit Court virtually ignored the public's "paramount" First Amendment right to receive information from diverse sources. While recognizing that government promotion of such interests is significant, the decision under review gave scant attention to these concerns in addressing whether the statutory provision at issue here is a narrowly tailored remedy.

First, the Circuit Court's exclusive concentration on the RBOCs' rights as speakers, without regard to the public's rights as recipients of information, was fundamental error. Second, the Court similarly erred in finding that there was an "obvious less burdensome alternative," to the cross-ownership ban. If the narrowly tailored analysis standard is to mean anything at all, the so-called "less burdensome alternative" must be real, and not theoretical. For this reason, the Court's reliance on the FCC's video dialtone scheme is misplaced. There is currently no viable VDT service. While a handful of test market installations serving perhaps several thousand people are now under way, it is far from certain that this technology will prove workable in a truly competitive market. Moreover, there is evidence that at least some of the RBOCs have no intention of providing such service, and that they are primarily interested in buying existing cable systems and monopolizing the video programming market.

Finally, the Court's determination that RBOCs lack "ample alternatives of communication" in their service areas is incomplete. The RBOCs can own and operate television stations and thereby

obtain cable access through "must carry" provisions of the 1992 Cable Act. They can deploy multi-channel "wireless cable" services and market their own programming to broadcasting, cable and direct broadcast satellite operators. They also have the option of leasing channels on cable systems.

ARGUMENT

I. THE CIRCUIT COURT PAID LIP SERVICE TO THE PUBLIC'S RIGHT TO RECEIVE INFORMATION FROM DIVERSE SOURCES.

The Circuit Court properly recognized that "'assuring that the public has access to a multiplicity of information sources is a governmental purpose of the highest order, for it promotes values central to the First Amendment.'" *Chesapeake & Potomac Telephone Co. v. US*, 42 F.3d 181, 198 (4th Cir. 1994) (*"C&P Telephone"*) ***quoting*** *Turner Broadcasting Inc. v. FCC*, 114 S.Ct. 2445, 2470 (1994). As this Court held in its unanimous ruling in *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 390 (1969),

> It is the right of the viewers and listeners,...which is paramount. It is the purpose of the First Amendment to preserve an uninhibited marketplace of ideas in which truth will ultimately prevail, rather than to countenance monopolization of that market....It is the right of the public to receive suitable access to social, political, esthetic, moral and other ideas and experience which is crucial here.

However, far from examining how the cross-ownership ban "properly balances" the First Amendment rights of the parties, *CBS Inc. v. FCC*, 453 U.S. 367, 397 (1981), and specifically whether it promotes the *public's* First Amendment right to receive information from diverse sources, *Associated Press v. U.S.* 326 U.S. 1, 20 (1945), the lower Court's analysis of narrow tailoring was conducted entirely from the perspective of how the ban may impact the rights of the RBOCs as speakers. *C&P Telephone*, 42 F.3d at 199-202.

Although the Circuit Court went so far as to accept that telephone companies have the incentive to act anticompetitively in the video program market to restrict diversity, *id.* at 200, and to

"assume that the possibility that a telephone company may engage in cross-subsidization in the cable transport market presents a problem," *id.* at 201, it went no further. Indeed, the Court's complete disregard for the public's right to diverse information is best demonstrated by the footnote following its "assumption." There, it echoed the District Court in stating that

> '[e]ven under the government's worse case scenario, in which the telephone companies succeed in driving out all competition for the provision of video transport service, the telephone companies would be in no better position to act anti-competitively in the video programming market than are the current monopolists in the video transport market, the existing cable operators.'

C&P Telephone, 42 F.3d at 201 n.31 ***quoting*** *C&P Telephone v. US*, 830 F.Supp. 909, 930 (E.D. Va. 1993).

The Circuit Court's callous disregard of the effects on diversity of replacing one monopoly with another clearly demonstrates that it did not properly consider the public's First Amendment rights in this case.[1] This inattention to diversity takes on greater meaning in the face of numerous recent media mergers[2]

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[1]*See also* Angela J. Campbell, *Publish or Carriage: Approaches to Analyzing The First Amendment Rights of Telephone Companies*, 70 N.C.L. Rev. 1071, 1116-1119 (1992), which argues that the narrowly tailored test is ill-fitted for First Amendment cases in which the speaker is also a common carrier, because the test is premised "on the assumption that there are only two relevant parties-a speaker who wants to speak and a government that wants to limit that speech,..." while it ignores the interests of the telephone companies' customers, who have rights as speakers and receivers of information that will be burdened if telephone companies can monopolize their wires; D.L. Bazelon, *FCC Regulation of the Telecommunications Press*, 1975 Duke L.J. 213 (1975).

[2]Disney's proposed acquisition of the ABC television network, and Westinghouse Broadcasting's contract to buy the CBS television network are but two of the largest and most widely publicized transactions of the many recent and pending media mergers and consolidations. Barely no-

(continued...)

and Congressional proposals to permit further consolidation of control of the video programming and transport markets by eliminating broadcast multiple ownership and cross-ownership restrictions.[3]

II. THE COURT'S DETERMINATION THAT THERE IS AN "OBVIOUS LESS BURDENSOME ALTERNATIVE" TO THE TELCO/CABLE CROSS-OWNERSHIP BAN IGNORES PRACTICAL REALITIES.

The Circuit Court undertook an exceptionally superficial analysis of whether, under intermediate scrutiny, the telco/cable cross-ownership ban is narrowly tailored to meet that goal. It found that the ban was not narrowly tailored because, *inter alia*, an "obvious less burdensome alternative" to the ban "readily presents itself." *C&P Telephone*, 42 F.3d at 202 *citing Video Dialtone Order*, 7 FCCRcd 5781 (1992).

Even were this "alternative" already available, the mere possibility that such alternatives *might* develop does not get over the hurdle established by *United States v. O'Brien*, 391 U.S. 367 (1968). A regulation is not "invalid simply because there is some imaginable alternative that might be less burdensome on speech." *United States v. Albertini*, 472 U.S. 675, 689 (1985). A restriction is permissible under *O'Brien* "so long as the neutral regulation promotes a substantial government interest that would be achieved less effectively absent the regulation." *Id.*

But the "less burdensome alternative" identified by the Court - limiting RBOCs' editorial control over video programming to a fixed percentage of the channels available - is neither effective nor viable. It is in fact no alternative at all.

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[3](...continued)

ticed amid the attention to these transactions was NBC's acquisition - during the same week - of several major market TV stations for $396 million. "Outlet sells for $396 million to NBC," Broadcasting & Cable Magazine, August 7, 1995, at 64.

[3]See S. 652, 104th Cong., 1st Sess., §206(b) (1995); H.R. 1555, 104th Cong., 1st Sess., §302(a)(1995).

The FCC has considered and approved a few VDT applications. It has recently taken steps to expedite its processing of such submissions. *Fourth Report and Order*, FCC No. 95-357 (Released August 14, 1995). Even so, there are now but a handful of test market installations serving perhaps several thousand people. No one maintains that VDT technology is ready for large scale deployment, and it is far from certain that this technology will prove workable in a truly competitive market. Indeed, assuming all pending VDT applications are approved and fully constructed, they would reach perhaps 5% of all telephone subscribers.

Nor is it clear that VDT systems will ever be built at all. Just recently, "US West Inc. pushed back its bold interactive-network plans for up to a year, asking federal regulators to suspend review of five pending applications to build video networks." *US West Inc. Puts a Hold on Its Plans To Build Interactive Video Networks*, *Wall Street Journal*, June 1, 1995, at B2. The move came a week after "Bell Atlantic Corp. asked the FCC to suspend consideration of its two pending [VDT] applications,...saying it wanted to review new technologies in the market." *Id.* While "US West insisted it isn't abandoning plans to build an advanced communications network...," a US West executive "said he couldn't...rule out the possibility that US West may decide to follow in the footsteps of Bell Atlantic and withdraw its pending application completely." *Id.*[4] Shortly thereafter, NYNEX's Southern New

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[4]*See also Plan Stalls for Video Network*, *The Baltimore Sun*, May 29, 1995 at 13C. ["Bell Atlantic Corp. has formally withdrawn its application to the Federal Communications Commission for permission to build an advanced video network in Baltimore and five other metropolitan areas, saying it would file a new plan in late 1995 or early 1996. The company said it has withdrawn its original application because it was now technologically outdated. The decision to withdraw the so-called Section 214 application comes a month after Bell Atlantic asked the commission to put the matter on hold, saying it wanted to re-evaluate the system architecture. At the time, Bell Atlantic said it was having misgivings about its plans to build a system modeled upon cable television networks -- using both (continued...)

England Telephone subsidiary (SNET) "threaten[ed] to pull back its planned statewide construction of [a VDT network]...." *SNET fires back at Connecticut regulators[.] Connecticut telco holds out threat of pulling back from video*, *Broadcasting & Cable*, July 3, 1995 at 23. In exceptions to a state PUC's draft decision, SNET said that proposed cost-allocation procedures "would cause SNET to reconsider its entire...deployment plan, and specifically, its entry into the video market using an HFC architecture." *Id.*

Telcos have gone far beyond the exploration of other, non-VDT alternatives. Bell Atlantic and NYNEX have invested approximately 100 million dollars in a new wireless technology available for immediate deployment. This service, called MMDS, or "wireless cable," enables delivery of perhaps 100 TV channels almost immediately on current TV receivers.[5] Indeed, Ameritech was recently awarded a franchise to provide cable service in its telephone service area. *Ameritech goes cable*, *Broadcasting & Cable*, July 3, 1995 at 6.

What the RBOCs reticence (or inability) to operate VDT systems serves to highlight is that the "worst case scenario" the Circuit Court described is based in reality: some RBOCs may be

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[4](...continued)

traditional coaxial cable and advanced fiber-optic cable, and architecture known as hybrid fiber-coax."]

[5]*See Bell Atlantic Changes its TV Plans -- Again*, *Washington Post*, May 17, 1995 at F1. ["Once again, Bell Atlantic Corp. has changed the way it wants to give you television service. By the end of 1996, the local telephone provider hopes to compete against local cable operators by offering more than 100 channels of video programs to 70 percent of the homes in the Washington region. But the TV shows won't be coming over any lightning-fast fiber-optic network. Instead, Bell Atlantic plans to deliver them over the air to 18-inch home dishes via high-frequency microwave signals, using an existing technology popularly known as "wireless cable" TV. **** The signals would go over wireless cable networks owned by CAI Wireless Systems, the wireless cable firm that Bell Atlantic and another regional phone company, Nynex Corp., agreed to invest $100 million in last March."]

less interested in competing with cable operators, than with replacing them.

This problem will only become exacerbated, if, as expected, the FCC rules that RBOCs that provide programming on a VDT system are providing "cable service" under 47 USC §522 (5)-(6),[6] and therefore are required to obtain a franchise from the local franchising authority pursuant to 47 USC §541(b).[7] *FCC pondering franchise fees for telcos, Broadcasting & Cable,* July 3, 1995 at 23. It is inconceivable that any RBOC would choose to operate an open system under Title II if it is required in any event to get a franchise under Title VI. The FCC's decision would destroy any incentive to engage in VDT.

III. THE CIRCUIT COURT ERRED IN FINDING THAT RBOCs DO NOT HAVE AMPLE ALTERNATIVE CHANNELS FOR COMMUNICATION.

The Circuit Court also determined that the cross-ownership ban did not provide RBOCs with ample alternative channels for communication so as to survive intermediate scrutiny. *C&P Telephone*, 42 F.3d at 202-203. Although the Court recognized that RBOCs can own cable systems outside their service areas, it asserted that "the telephone companies remain unable to reach the audience of their common carrier subscribers should they so

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[6]47 USC §522(5) states: "the term 'cable operator' means any person or group of persons (A) who provides cable service over a cable system and directly or through one or more affiliates owns a significant interest in such cable system or (B) who otherwise controls or is responsible for, through any arrangement, the management an operation of such a cable system.

47 USC §522(6) states: "the term 'cable service' means- (A) the one-way transmission to subscribers of (i) video programming, or (ii) other programming service, and (B) subscriber interaction, if any, which is required for the selection of such video programming or other programming service;..."

[7]That section states, in pertinent part, "a cable operator may not provide cable service without a franchise."

choose." *Id.* at 203.

Here again, the Court has ignored the reality of the video marketplace. There are many ways for RBOCs to obtain access to audiences within and outside their service areas. RBOCs can provide programming in their service areas through marketing it to cable operators, broadcasters, or direct broadcast satellite systems.[8] Indeed, given recent RBOC alliances with such programming experts as Capital Cities/ABC Television Network (soon to be owned by Disney, a prolific television and movie producer) and former CBS Television Network program chief Howard Stringer, there is no reason to believe RBOC programming will not be attractive to these outlets. Moreover, cable commercial leased access channels or public access channels are available on a nondiscriminatory basis to all video programmers that are unaffiliated with a cable operator. 47 USC §§531-532.

As noted above, RBOCs are not precluded from other forms of video distribution, and several have taken steps for immediate entry into video programming via "wireless cable." Moreover, there is no bar to telco ownership of broadcast licenses; like all commercial broadcasters, their stations are entitled to mandatory carriage pursuant to 47 U.S.C. §534.

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[8]The Circuit Court admits that the District Court made this observation and does not dispute it. Instead, it cites to a so-called "inconsistent statement" by the District Court that was raised in that Court's discussion of narrow tailoring. *C&P Telephone*, 42 F.3d at 202 n. 36.

CONCLUSION

For the foregoing reasons, the judgment of the United States Court of Appeals for the Fourth Circuit should be reversed.

Respectfully submitted,

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August 18, 1995

BEST AVAILABLE COPY

QUESTION PRESENTED

Whether 47 U.S.C. § 533(b), which prohibits local telephone companies from providing video programming directly to subscribers in their telephone service areas, violates the First Amendment.

RULE 29.1 STATEMENT

Amicus curiae GTE Corporation is a publicly-held corporation in the business of providing telecommunications services and products to the general public. GTE Corporation is the parent company of GTE Service Corporation and the GTE telephone operating companies. The following subsidiaries of GTE Corporation have securities in public hands:

B.C. Telecom, Inc.
Caribbean Reservation Center, C. por. A.
Communications Telefonicas, C. por. A.
Florence Cellular Telephone Company, Inc.
GTE California Incorporated
GTE Directories Corporation Lanka (PVT.) Ltd.
GTE Florida Incorporated
GTE Hawaiian Telephone Company Incorporated
GTE North Incorporated
GTE Northwest Incorporated
GTE South Incorporated
GTE Southwest Incorporated
Jacksonville Cellular Telephone Corp.
Jacksonville Cellular Communications, Inc.
La Compagnie de Telephone Anglo-Canadienne/
Anglo-Canadian Telephone Company
MTX Italia
Parque Industrial ITABO, S.A.
Quebec-Telephone
Radiowealth, Inc.
The Micronesian Telecommunications Corporation
Wilmington Cellular Telephone Corp.
Wilmington Cellular Communications, Inc.
Zona France Las Americas

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Nos. 94-1893; 94-1900

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, ET AL.,
and
NATIONAL CABLE TELEVISION ASS'N, INC.,
Petitioners,

v.

BELL ATLANTIC CORPORATION, ET AL.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF FOR GTE CORPORATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

INTEREST OF *AMICUS CURIAE*

Amicus curiae GTE Corporation and its affiliated companies ("GTE") are in the business of providing telecommunications services and products, including local telephone services, to the general public. *Amicus*, like Bell Atlantic, has challenged the constitutionality of 47 U.S.C. § 533(b), which prohibits telephone companies from providing "video programming" to subscribers in their service areas. In *GTE South v. United States*, Civ. Action No. 94-1588-A (E.D. Va. Jan. 15, 1995), the District Court declared that Section 533(b), on its face, violates GTE's right of free speech

guaranteed by the First Amendment of the United States Constitution. The Government has filed a notice of appeal in *GTE South*, but the parties have agreed to stay that appeal pending resolution of this case by this Court. *Amicus* GTE Corporation therefore has a substantial interest in this Court's determination of the constitutionality of Section 533(b).[1]

SUMMARY OF ARGUMENT

Amicus GTE agrees with respondent Bell Atlantic that Section 533(b), as a direct ban on speech, should be subject to strict scrutiny, and that, under *either* strict scrutiny or intermediate scrutiny, Section 533(b) is unconstitutional.

In this brief, *amicus* GTE discusses the impact of the FCC's *Third Report and Order* on this litigation. (May 1995 Supplemental Brief of Petitioners In Support of Petition For A Writ of Certiorari 1a-21a ("Gov't Supp. Br."). In the *Third Report and Order*, the FCC concluded that Section 533(b)(4) authorizes it to grant waivers to Section 533(b)'s unequivocal prohibition on telephone companies providing video programming in their service areas. The FCC explicitly declined, however, to specify in the *Third Report and Order* any of the terms and conditions that it would require for a waiver of Section 533(b), promising only to announce those terms and conditions sometime in the future.

In their briefs, the Government and the National Cable Television Association ("NCTA") attempt to characterize the *Third Report and Order* as a "saving construction" of Section 533(b), one which purportedly avoids the constitutional infirmities with that section found by every district and circuit judge to consider the merits of the issue. However, as we

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[1] GTE has obtained the written consent of petitioners, the United States and the National Cable Television Association ("NCTA"), as well as of respondent Bell Atlantic Corporation, to file this *amicus* brief. The letters of consent are on file with the Clerk of this Court.

demonstrate herein:

1. The *Third Report and Order* is not a "saving construction" of Section 533(b), if for no other reason than it is not a "construction" of the scope of that prohibition's ban of speech. The *Third Report and Order* purports to construe the FCC's *waiver authority under Section 533(b)(4)*, but in doing so, it does not purport to delineate in any specific way the reach of *Section 533(b)(1)-(2)'s ban on speech*. It is difficult to fathom how the Government and the NCTA can ask this Court to hold that the *Third Report and Order* alleviates the constitutional infirmities in Section 533(b) when the *Third Report and Order* does not even purport to specify what speech will be allowed under the waiver regime that it contemplates and what speech will remain prohibited by Section 533(b).

2. In any event, the waiver regime contemplated by the *Third Report and Order* is no less unconstitutional than Section 533(b) itself. The *Third Report and Order* replaces an unconstitutional flat ban on speech with an equally unconstitutional flat ban on speech subject to waivers to be granted by bureaucrats according to standards, and subject to conditions, of their own making, which are as yet unknown and which in any event are not meaningfully constrained by any language in the statute. Such a standardless licensing scheme plainly violates the First Amendment.

3. The real significance of the *Third Report and Order* lies not in its uselessness as a "saving construction," but rather in the crucial concessions made in it by the FCC. As we demonstrate in Part III below, in the course of justifying its authority to grant waivers to Section 533(b), the FCC undermines the arguments advanced by the Government in defense of Section 533(b). In short, far from saving Section 533(b), the *Third Report and Order* buries it even deeper.

ARGUMENT

I. THE *THIRD REPORT AND ORDER* CANNOT BE A "SAVING CONSTRUCTION" OF SECTION 533(b) BECAUSE IT IS NOT EVEN A "CONSTRUCTION" OF THE SCOPE OF SECTION 533(b)'S BAN ON SPEECH.

The most basic reason why the *Third Report and Order* is not a "saving construction" of Section 533(b) is that it is not a "construction" of that prohibition's ban on speech. In the *Third Report and Order*, the FCC construes generally its *waiver authority under Section 533(b)(4)*, but in doing so it does not in any specific way delineate the reach of *Section 533(b)(1)-(2)'s ban on speech*. There is simply no basis for this Court to conclude that the *Third Report and Order* sufficiently narrows the scope of the statutory ban on speech to save it from unconstitutionality, because the FCC *explicitly* disavows determining the terms and conditions under which telephone companies will be allowed to speak.

In its brief, the NCTA mischaracterizes the *Third Report and Order* as having "explicitly concluded that [the] direct provision of video programming [by telephone companies] *is* authorized under [a] single set of conditions." (NCTA Br. 28 (emphasis in original).) This statement could not be further from the truth. The *Third Report and Order* most assuredly does not determine *any* "single set of conditions" under which telephone companies will be allowed to speak. Although the FCC concludes in the *Third Report and Order* that it has "the *legal authority* to grant waivers allowing telephone companies to provide video programming in their telephone service areas on video dialtone networks," (Govt. Supp. Br. 2a (emphasis added)), it explicitly "do[es] not decide whether telephone companies may provide video programming over video dialtone networks rather than as traditional cable operators," (*id.*). Nor, the FCC states explicitly, does it decide in the *Third*

Report and Order under what "terms and conditions" a telephone company will be allowed to provide video programming. (Govt. Supp. Br. 6a, n.11.) Nor does the FCC even decide generally whether, "*if* a telephone company is permitted to provide video programming on a video dialtone system, . . . that telephone company should be regulated [as a common carrier] under Title II or [as a cable operator under] Title VI of the Communications Act." (Govt. Supp. Br. 2a-3a (emphasis added).)[2]

In short, the *Third Report and Order* settles *nothing* about the scope of Section 533(b)'s ban on speech. Instead, it merely decides that the FCC has the *authority* under Section 533(b)(4) to issue good cause waivers to allow telephone companies to provide video programming over a video dialtone network *if* the FCC ultimately decides that it wants to do so, and subject to conditions not yet determined. Because the *Third Report and Order* does not even purport to determine the scope of Section 533(b)'s ban on telephone company speech, it cannot be a narrowing construction that saves Section 533(b) from the conclusion that the statute is facially unconstitutional under the First Amendment. *See Secretary of State of Md. v. Joseph H. Munson Co.*, 467 U.S. 947, 967-68 (1984) (statute that imposes direct restriction on speech that is too imprecise to satisfy First Amendment is "properly subject to facial attack," and "[t]he possibility of a waiver may decrease the number of impermissible applications of the statute, but it does nothing to remedy the statute's fundamental defect").

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[2] The only hint in the *Third Report and Order* as to the conditions under which the FCC will grant a waiver to Section 533(b) is the FCC's statement that "video dialtone necessarily includes a common carriage element," thus indicating that the FCC will likely try to use Section 533(b) to impose a common carrier requirement on telephone companies, which it cannot impose on cable companies. But again, in this very same paragraph, the FCC explicitly reiterates that it "ha[s] not yet adopted definitive rules governing the conditions under which telephone companies may be permitted to act as video programmers." (Govt. Supp. Br. 13a.)

II. THE WAIVER REGIME EMBODIED IN THE *THIRD REPORT AND ORDER* IS AN UNCONSTITUTIONAL STANDARDLESS LICENSING SCHEME.

In any event, the FCC's interpretation in the *Third Report and Order* of its waiver authority does not alleviate the constitutional infirmities in Section 533(b). Indeed, if anything, it *compounds* them by vesting in the FCC an unconstrained, standardless licensing power over the free speech rights of telephone companies. *See Forsyth County, Ga. v. Nationalist Movement*, 112 S. Ct. 2395, 2401-03 (1992); *City of Lakewood v. Plain Dealer Publishing Co.*, 486 U.S. 750, 757, 769-72 (1988); *Joseph H. Munson Co.*, 467 U.S. at 964 n.12. The *Third Report and Order*, in other words, impermissibly "trade[s] a direct prohibition on [telephone company speech] for a licensing scheme that, if it is available to [telephone companies] at all, is available only at the unguided discretion of the [FCC]." *Joseph H. Munson Co.*, 467 U.S. at 964 n.12.

Section 533(b) makes it flatly unlawful for telephone companies to provide video programming, either directly or indirectly, to subscribers in its telephone service area. In the *Third Report and Order*, the FCC promises that it will "routinely" grant waivers to that seemingly unequivocal prohibition for "good cause," (Govt. Supp. Br. 4a), but only "where the telephone company agrees to abide by the regulations we will establish governing its provision of video programming," *id.* at 19a. As noted above, in the *Third Report and Order*, the FCC does not purport to determine the terms and conditions to which it will require a telephone company to agree before it will grant the telephone company a good cause waiver to provide video programming. Nor does Section 533(b) set up any special procedure either for setting the terms and conditions for "good cause" or for considering requests from a telephone company for such a waiver.

In the past, this Court has looked with suspicion at statutes and ordinances that grant executive officials the power to grant or deny a license to speak. As the Court noted in *Joseph H. Munson Co.*, "[b]y placing discretion in the hands of an official to grant or deny a license [to speak], such a statute creates a threat of censorship that by its very existence chills free speech." 467 U.S. at 964 n.12. *See City of Lakewood*, 486 at 757 ("mere existence of the licensor's unfettered discretion, coupled with the power of prior restraint, intimidates parties into censoring their own speech"). Section 533(b), as construed by the *Third Report and Order*, has all of the attributes that this Court has found unacceptable in unconstitutional speech-licensing schemes.

In particular:

First, a legislature "cannot vest restraining control over the right to speak [in] an administrative official where there are no appropriate standards to guide his action." *Kunz v. New York*, 340 U.S. 290, 295 (1951). Here, there are no meaningful standards in Section 533(b) to restrain the exercise of the FCC's discretion to grant or deny a waiver. Nothing in the statute purports to constrain the terms and conditions that the FCC can require before it will grant a waiver to Section 533(b)'s flat ban on speech, and nothing in the statute ensures that the FCC will apply those terms and conditions consistently, uniformly, or fairly once it has set them.

The fact that the statute authorizes waivers for "good cause" does not constitutionally constrain the discretion of the FCC. There is no statutory definition of "good cause," and nothing in the statute otherwise constrains the terms and conditions that the FCC may set for waivers. It is inconceivable that this Court would uphold against First Amendment challenge a city ordinance that made all picketing illegal, on the ground that the ordinance allowed the police commissioner to grant a waiver for "good cause." And we must believe that it would make no difference to this Court if the police commissioner promised, as the FCC has done, to

issue waivers "routinely" according to "speech friendly" standards that he would not even begin to develop until after the Court had decided the constitutional challenge raised in the case.

Second, a speech-licensing scheme violates the First Amendment unless it contains numerous procedural safeguards, all of which are lacking here. In *Freedman v. Maryland*, 380 U.S. 51 (1965), this Court struck down a state law that prohibited the exhibition of any motion picture without first submitting it to a state administrative board for review. Even though the state law had established a detailed set of procedures to govern decisions made by the administrative board, this Court held that the scheme violated the First Amendment because certain other protections were lacking. These additional safeguards, which the Court held to be essential, included: (i) that the government officials must have the burden of proving that any decision they make to suppress speech is constitutional; (ii) that any such decision must be made within a specified brief period; and (iii) that expedited judicial proceedings to review the decision must be assured. *Freedman*, 380 U.S. at 58-60.

None of these procedural safeguards, and nothing like them, is present in Section 533(b) or in the *Third Report and Order*. The FCC has not even established the substantive terms and conditions to govern its waiver power, much less whether it will implement such rigorous procedures in considering requests for a waiver. There is no onus on the FCC to prove why a telephone company should not be allowed to speak; rather, Section 533(b) provides that, unless the telephone company receives a waiver, it cannot speak. There is no requirement that the FCC must decide waiver applications within any specified brief time, and it is stipulated in this case that waiver applications have languished at the FCC *for years*. (*See* J.A. 204-05.) And there is neither any provision for expedited judicial review of the denial of a waiver by the FCC nor any meaningful standards in the statute by which a court

could judge the FCC's exercise of its broad discretion. In short, *none* of the important procedural safeguards necessary for a constitutional system of speech licensing is present here.

Third, the Court has previously held that, if a legislative body could have served the relevant government interests in an alternative manner that is obviously less burdensome to speech, a statute is not saved by the fact that an executive official can give dispensation to speak. The Court made this important point explicitly in *Joseph H. Munson Co.*, where it held that the possibility of a waiver from a statutory prohibition of speech does not save a statute when the government's interests could have been protected by a restriction that was less burdensome on speech: "[W]here there are alternative means to serve the same purpose, there is little justification for straining to salvage the statute by invoking the possibility of official dispensation to engage in protected activity." 467 U.S. at 964 n.12.

The importance of this point cannot be overemphasized. If this Court were to accept petitioners' argument that the *Third Report and Order* avoids the constitutional difficulties with Section 533(b), then the "less restrictive alternative" requirement embodied in both strict and intermediate scrutiny (in First Amendment jurisprudence and elsewhere) would be a virtual dead letter. All that a legislature would have to do to avoid this requirement would be to include in the statute the authority of an executive official to waive the statutory prohibition for "good cause." Then, so long as the executive official promised to apply the statute in ways that were less intrusive than the statute itself (even if the executive official would not specify the terms and conditions under which he would grant a waiver), the statute would be able to survive heightened scrutiny. That cannot be acceptable. The relevant constitutional question must be whether *the legislature* could have drawn the statutory ban more narrowly, without compromising the government's important interests, not whether an executive official has the authority to narrow the application of an overbroad prohibition that is not necessary to

serve the government's asserted interests.

For all of these reasons, the waiver scheme embodied in the *Third Report and Order* does not alleviate the constitutional infirmities of Section 533(b).

III. THE *THIRD REPORT AND ORDER* CONFIRMS THAT SECTION 533(b)'S BAN ON TELEPHONE COMPANY SPEECH IS NOT NECESSARY TO PREVENT THE EVILS THE GOVERNMENT RELIES ON TO JUSTIFY THE STATUTE.

The real significance of the *Third Report and Order* to this litigation lies not in its uselessness as a "saving construction," but rather in how the findings and determinations of the FCC contained therein undermine the Government's justifications for Section 533(b)'s flat ban on telephone company speech.

To support its conclusion that it can waive Section 533(b)'s ban on telephone company speech (subject to unspecified conditions), the FCC makes at least *five* crucial concessions in the *Third Report and Order*. Those concessions confirm that Section 533(b)'s ban on telephone company speech is not necessary to prevent the purported evils used by the Government to justify it.

1. The *first* major concession in the *Third Report and Order* concerns the original purported justification for the ban on video programming by telephone companies. Throughout this litigation, the Government has argued that the ban on telephone company speech now embodied in Section 533(b) was originally justified as necessary in order to allow the cable companies the time and opportunity to build and develop a nationwide cable television system that was independent of the

control of the telephone companies. (*See* Govt. Br. 6.)[3] In the *Third Report and Order*, the FCC expressly concedes that any fear that the telephone companies could extinguish the development of an independent cable industry is "no longer relevant" because since 1970, "the cable industry has grown from a fledgling service to a more mature industry that now serves a majority of households and 'has replaced over-the-air broadcast television as the primary provider of video programming.'" (Govt. Supp. Br. 11a (quoting *Turner Broadcasting Sys., Inc. v. United States*, 114 S. Ct. 2445, 2454 (1994).)

2. The *second* major concession in the *Third Report and Order* is the FCC's acknowledgment that, in light of "significant advances in technology," it is now "possible for a multitude of programmers to reach end user customers." (Govt. Supp. Br. 11a-12a.) What this means is that, in light of developments in technology, *but for the impact of Section 533(b)*, there could now be at least *two* ways for any video speaker to reach his or her end-user audience -- either over the existing nontelephone company cable delivery system *or* over the telephone company's telephone network. In an artfully worded understatement, the FCC concedes that these advances in technology "have mitigated to a fair degree the competitive concerns that led the Commission and Congress to" ban telephone company video programming. (Govt. Supp. Br. 12a.)

3. The *third* major concession in the *Third Report and Order* relates to the overall effect on competition in the provision of video programming if the telephone companies were allowed to speak over their own separate system. The

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[3] The Government contends that the FCC's original ban on telephone company video programming was "[i]ntend[ed] to insure against arbitrary blockage of the gateway and to preserve a competitive environment for the development and use of broadband cable facilities and services and thereby avoid undue and unnecessary concentration of control over communications media either by existing carriers or other entities." (Govt. Br. 6) (quotations omitted).)

FCC explicitly recognizes that "it *does* promote competition to allow a telephone company to provide video dialtone service in its telephone service area in competition with an existing cable company." (Govt. Supp. Br. 16a-17a (emphasis in original).) According to the FCC, what "generally would *not* promote competition [would be] to allow a telephone company to purchase an incumbent monopolist cable operator in the telephone company's service area." (Govt. Supp. Br. 16a (emphasis added).) But Section 533(b) does not even prohibit a telephone company from buying the incumbent cable operator.[4] Rather, it prohibits a telephone company from providing video programming *over its own telephone network or through a separate stand-alone cable system.* In other words, what Section 533(b) prohibits is precisely what the FCC finds in the *Third Report and Order* would promote competition with the incumbent cable monopolists and would provide video speakers with more than one way to reach their audiences. Thus, the FCC effectively concedes that, as written, Section 533(b)'s flat ban on telephone company video programming actually *hinders* the very goals of competition and diversity of voices that the Government argues it is designed to promote.

The combination of these first three concessions -- (i) that the cable companies are now firmly entrenched across the nation; (ii) that technology, unfettered by Section 533(b), would allow video speakers to reach their audiences both over a traditional cable system and through the telephone company network; and (iii) that it would promote, not hinder, competition to allow a telephone company to provide video programming in competition with the incumbent cable monopolist -- has enormous significance for the First

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[4] Section 533(b) does not prohibit a telephone company from buying the incumbent cable company, so long as the telephone company does not provide the video programming on that system. This further shows that Section 533(b) does not remotely serve the competitive goals that the Government has advanced in support of it.

Amendment analysis in this case. Specifically, in light of these concessions, it is clear that the only governmental interest that could possibly suffice to justify banning telephone companies from providing video programming would be if the Government could show that telephone company entry into video programming would *drive the incumbent cable companies out of the market*. Otherwise, it is better to have two competitors in each market, and two ways for video speakers to reach their intended audiences, than to have only one, even if the telephone companies do not compete perfectly.

What does this mean for the interests advanced by the Government in support of Section 533(b)? First, it makes some of the Government's arguments utterly *irrelevant*. For example, the Government places great weight on the speculation that telephone companies could discriminate against unaffiliated video *programmers*, arguing that "LECs could use their control over the network to ensure that the quality of their own video signal is better than that of [unaffiliated video programmers]." (Govt. Br. 36.) But even if that were true -- a dubious proposition[5] -- it is irrelevant. For,

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[5] The Government does not attempt to explain how it would be technologically feasible for a telephone company that was delivering a video signal with scores of different channels into an end-user's home to degrade the quality of the signal for some channels (those carrying programs of unaffiliated video programmers) while maintaining the quality of the signal for other channels (those carrying the telephone company's affiliated programming). Technology is not voodoo. If intermediate scrutiny under *United States v. O'Brien*, 391 U.S. 367 (1968), and *Ward v. Rock Against Racism*, 491 U.S. 781 (1989), is to have any bite, the Government must carry the burden of establishing that the anticompetitive evils it relies upon to uphold a ban on speech are technologically feasible. The Government has wholly failed to do that in this case. Moreover, in other cases involving voice and data information services, the Government has previously agreed and documented that "there is no substantial risk that a [telephone company] could impede competition through discrimination" against competing providers. Ct. App. JA 2631, 2635. It is absurd for the Government to talk out of one side of its mouth with respect to voice and data services and out of the other side of its mouth to try to uphold Section 533(b)'s ban of video services. In any event, even if a telephone company could degrade the

whatever ability the local telephone company may have to discriminate against unaffiliated programmers, the incumbent cable company has the same ability. If either the telephone company or the incumbent cable company can discriminate against unaffiliated programmers, then it is obviously preferable, from the standpoint of both competition and diversity of voices, that the telephone company be given the incentive to enter the market in competition with the incumbent cable company.[6] Then, if an unaffiliated programmer is discriminated against by either the incumbent cable company or the telephone company, that unaffiliated programmer will (for the first time since the inception of cable television) have somewhere else to turn, and can play the telephone company off against the cable company.

Discrimination against unaffiliated upstream competitors who require access to a downstream firm's facilities is grounds for exclusion of that downstream firm from the upstream market only if (if at all) the downstream firm's facilities are the only way to reach end-line consumers.[7] That principle would

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quality of the signal solely for unaffiliated programming, the end-user would surely blame, and hold accountable, the telephone company (which is delivering the signal), not the unaffiliated programmer.

[6] In recommending the repeal of Section 533(b), the National Telecommunications and Information Administration, part of the Department of Commerce, found that telephone companies would likely not have the incentive to invest in the infrastructure necessary to provide video signals over their own network in competition with the cable companies unless the telephone companies could also provide video programming over their networks. *See* J.A. 345

[7] It is this basic principle that makes the NCTA's analogy of Section 533(b) to the breakup of the Bell System fatuous. (*See* NCTA Br. 39.) The reason the Justice Department thought it appropriate to break up the Bell System and then exclude the local Bell telephone companies (such as Bell Atlantic) from providing long-distance service was the fear that a local Bell telephone company could discriminate in favor of its affiliated long-distance provider in access to what was characterized as its "bottleneck" local telephone exchange. The key to the exclusion was that unaffiliated long-distance providers had nowhere else to turn to reach customers in the local

be grounds to exclude the *incumbent cable monopolists* from providing video programming because, as things stand today, unaffiliated programmers must pass through *the incumbent cable companies' bottleneck facilities*. But that situation would no longer exist if telephone companies were allowed to speak over their own separate systems, thus providing unaffiliated programmers with an alternative to delivery through the incumbent cable companies' systems. And in no event is the possibility of such discrimination by the telephone companies grounds for barring them from providing video programming in competition with the incumbent cable monopolists. In short, all of the Government's arguments about the possibility that a telephone company would discriminate against unaffiliated video programmers are irrelevant, and could not possibly justify Section 533(b)'s ban on speech.

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telephone company's service area. But, whatever the merits of that position, it has always been considered gospel at the Justice Department and elsewhere that, as soon as there is competition at the local telephone exchange level (*i.e.*, as soon as the unaffiliated long-distance providers could access their customers or complete a long-distance call through a competitor to the incumbent local telephone company), there would no longer be any justification for preventing the local Bell company from providing long-distance service. Here, even if a telephone company discriminated against an unaffiliated programmer, the programmer could switch to the incumbent cable company for delivery of its programming.

It is particularly ironic that the NCTA would raise the analogy to the breakup of the Bell system and the exclusion of local Bell companies from the long-distance market. For today, the incumbent cable monopolists, through bottleneck control of *their* facilities, can prevent a particular video programmer from reaching an end user. If the Bell system analogy were followed here, *the incumbent cable companies would be prohibited from providing video programming* until there was a competing way for unaffiliated programmers to reach their audience. What Section 533(b) does is prevent the telephone companies from breaking the bottleneck held by the incumbent cable companies, thus depriving unaffiliated programmers of an alternative way of reaching their audiences. Thus, to the extent the lessons of the Bell system breakup apply here, they require that Section 533(b) be invalidated so that the incumbent cable companies' bottleneck control of the system of delivery of video speech can be broken.

Second, with respect to the Government's other arguments -- that Section 533(b) is necessary (i) to prevent telephone companies from discriminating *against the incumbent cable companies* in telephone pole and conduit access, and (ii) to prevent telephone companies from gaining unfair competitive advantage *against the incumbent cable companies* by allocating some of the costs of their video programming network to their rate regulated telephone network -- it should be clear that these imagined evils cannot possibly justify Section 533(b)'s ban on speech (even under intermediate level scrutiny) unless the Government demonstrates that they would be *so widespread* and *so pervasive* as to drive the incumbent cable companies out of the market. It is not enough for the Government to speculate that telephone companies may, here or there, engage in *some* discrimination in pole and conduit access, or *some* cross-subsidization. Rather, the Government must also show that such alleged discrimination and cross-subsidization could rise to a level sufficient to drive out the incumbent cable companies. Otherwise, yet again, a second imperfect competitor is better than a monopolist, and two ways for video speakers to reach their audiences are better than one. Here, the Government has not even *attempted* to show that cross-subsidies and discrimination in pole and conduit access could rise to the level of driving out the cable companies. To the contrary, the Government has consistently argued in the context of information services that there is "no substantial possibility" that a telephone company could even *impede* competition through cross-subsidies and discrimination, much less drive competing providers out of the market. Ct. App. JA 1906, 1909.[8] And, indeed, it would not pass the straight-face test to assert that these anticompetitive evils could rise to such a level without the FCC, the Congress, the state utility agencies, and

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[8] Notably, while amicus California Cable Television Association claims to have "unique knowledge of the incentive and ability" of GTE "to engage in anticompetitive behavior" against cable companies, CCTA Brief at 2, it fails to allege even a single instance of such conduct by GTE, much less the requisite pattern of widespread and pervasive conduct.

the courts noticing the problem and stepping in to solve it.

4. In any event, if there were ever any doubt as to whether the Government's twin makeweights -- discrimination and cross-subsidies -- are sufficiently serious as to justify Section 533(b)'s flat ban on speech, that doubt is removed by the *fourth* major concession made by the FCC in the *Third Report and Order*. In its brief, the Government describes the possibility of discrimination by telephone companies against competitors and improper cross-subsidies as nearly intractable problems, incapable of being effectively policed. (*See* Govt. Br. 34-36.) But the FCC is plainly not overwhelmed by these problems.

Specifically, in concluding that it can and should grant waivers to Section 533(b) for some telephone company video programming, the FCC necessarily concludes in the *Third Report and Order* that it can deal effectively with the problems of cross-subsidies and discrimination through less onerous methods than a flat ban on speech. Indeed, in the *Third Report and Order*, the FCC trumpets that it has *already* "developed a number of safeguards that are designed to prevent cross-subsidization and discrimination" by telephone companies providing video programming. (Govt. Supp. Br. 14a n.35.) According to the FCC, "[t]he safeguards against cross-subsidization include accounting and cost allocation rules that separate nonregulated service costs from the costs associated with providing basic regulated telephone service." (*Id.*) Similarly, the FCC notes that its "non-discrimination safeguards include a variety of rules designed to ensure that unaffiliated enhanced service providers have access to the network on the same basis as affiliated enhanced service providers and are not otherwise unfairly disadvantaged." (*Id.*) Moreover, the FCC explains, in its "ongoing rulemaking proceeding in this [matter]," it will decide whether any *additional* safeguards are needed. *Id.*

Thus, the *Third Report and Order* makes clear that the FCC -- the agency in charge of enforcing Section 533(b) --

believes that it can handle the purported problems of cross-subsidies and discrimination without completely banning the telephone companies from speaking to the subscribers in their service areas. In light of that concession, it seems unimaginable that the Government litigators' vague and speculative invocation of the purportedly intractable problems of discrimination and cross-subsidies could justify Section 533(b)'s flat ban on speech by the telephone companies.

5. The *fifth*, and perhaps most dispositive, concession in the *Third Report and Order* is the fundamental conclusion necessarily embodied in that order: *that there are obviously less intrusive ways of protecting the interests advanced by the Government in support of Section 533(b) than a complete ban on video speech by telephone companies over their own networks in their own service areas.* Although, as we demonstrated above, the *Third Report and Order* does *not* in fact adopt a specific less restrictive alternative to Section 533(b), it is undeniable that the *Third Report and Order* recognizes that such obviously less restrictive alternatives are possible, and, therefore, that *Congress* could adopt one by statute. That concession, under either strict or intermediate scrutiny, is absolutely fatal.

In sum, in its unseemly haste to persuade this Court to avoid passing on the constitutionality of Section 533(b) as enacted by Congress, the FCC has, perhaps unwittingly, undermined all of the arguments made by the Government litigators in defense of Congress' flat ban on speech and confirmed that the statutory ban on telephone company speech is not necessary to serve the interests asserted by the Government. In short, the *Third Report and Order* does not save Section 533(b), it buries it even deeper.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, *et al.*,
Petitioners,

v.

CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA, *et al.*,
Respondents.

NATIONAL CABLE TELEVISION ASSOCIATION, INC.,
Petitioners,

v.

BELL ATLANTIC CORPORATION, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF OF *AMICUS CURIAE* EAST ASCENSION TELEPHONE COMPANY IN SUPPORT OF RESPONDENTS

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INTEREST OF *AMICUS CURIAE*

East Ascension Telephone Company, Inc. provides local telephone service in parts of Louisiana. As a small telephone company, it cannot afford uneconomic investment to build a utopian common carrier video network as the sole means of providing video programming in its telephone service area. The disposition of this case urged by Petitioners, therefore, would have the practical effect of silencing East Ascension as a video speaker and of depriving East Ascension's subscribers of an alternative to the cable incumbent. Letters indicating the consent of the parties to the filing of this brief have been filed with the Clerk.

BACKGROUND OF THE CASE

At issue in this case is whether § 533(b) of the Federal Communications Act abridges telephone company speech in violation of the command of the First Amendment. The central argument has already been developed in the principal brief submitted by Bell Atlantic. Only a brief recapitulation of the basic facts is necessary here.

Through its subsidiary Bell Atlantic Video Services (BVS), Bell Atlantic seeks to provide video programming in direct competition with cable TV operators in Bell Atlantic's telephone service area. Section 533(b) bans all telephone companies, which are regulated as common carriers under the Federal Communications Act, from providing video programming to their telephone subscribers. Bell Atlantic, like East Ascension and other telephone companies, is caught by that restriction. Under § 533(b), any telephone company regulated by the FCC may passively transmit the programming of other providers over its own network; it may seek a broadcast license to transmit some of its own programming over a broadcast frequency in its own home region or elsewhere; it may sell its programming to cable TV stations anywhere so long as it can find a buyer; and it may provide video programming directly to customers outside its home region. But it cannot follow its obvious low-cost business strategy: Enter into the business of video programming in its own home region. The statutory prohibition holds whether a telephone company seeks to transmit its message over its own extant telephone facilities, or whether it seeks to build, purchase, or lease separate facilities for that purpose. And the statutory prohibition within the home territory holds whether the phone company

seeks to operate its video facilities as an ordinary private owner or as a common carrier.

This statutory ban on telephone company video programming amounts, as the Fourth Circuit held, to a flat prohibition of telephone company speech. Pet. App. 49a-51a. Given that unexceptional finding, the burden switches to the Government to justify that statutory prohibition by identifying some legitimate end of the ban, under (at the very least) a standard of intermediate scrutiny. And it must show that the legitimate end could not be achieved in a more expeditious and efficient way. *See Turner Broadcasting Sys. v. FCC*, 114 S. Ct. 2445, 2469-70 (1994). The Petitioners seek to meet that burden by showing that this legislative ban was, and is, necessary to prevent cross-subsidization of Bell Atlantic's video distribution services by its other common carriage telephone services. Their argument is that telephone companies hold powerful local monopoly positions that could allow them, if unchecked, to shift the costs of their video programming venture to their regulated businesses. The resulting subsidies could create distortions in two markets: the subsidized video programming market, and the subsidizing telephone market. *See generally* Averch & Johnson, *Behavior of the Firm Under Regulatory Constraint*, 52 Am. Econ. Review 1053-1069 (1962); Staff Report, FCC Policy on Cable Ownership (Nov. 1981), JA 54-58.

The Fourth Circuit assumed the theoretical legitimacy of the cross-subsidy concern, but held that the total ban of § 533(b) was nonetheless not tailored to fit the concern. In passing, the Fourth Circuit mentioned at least one less restrictive form of regulation available to the FCC: The FCC could allow the telephone companies to enter the video programming market in their own region, subject to common carrier obligations similar in form to those imposed on their core telephone business. That proposal was specifically tailored to fit the business plan of Bell Atlantic whose complaint alleged that BVS "will provide some of the video programming on the network, and the network will also be available for use by other video programmers on a common carrier basis." Complaint ¶ 28, JA 13.

Now, in its brief to this Court, the Government asserts that *all* telephone companies should be required to seek waivers of § 533(b) and that waivers will be dispensed only if the applicant submits to a common carriage requirement. Govt. Br. 40. This requirement would be contrary to the business plans of East Ascension Telephone Company, which wishes to enter the video programming market as an

ordinary private business and to compete on the same regulatory terms as the incumbent cable TV operators.

The Fourth Circuit explained its common carrier proposal as follows:

> Moreover, we agree with the district court, 830 F. Supp. at 930-31, that an "obvious less-burdensome alternative[ ]" to Section 533(b) readily presents itself (and indeed has been identified by the FCC as a possible alternative to Section 533(b) in its recommendation to Congress to repeal the provision): Congress could simply limit the telephone companies' editorial control over video programming to a fixed percentage of the channels available; the telephone companies would be required to lease the balance of the channels on a common carrier basis to various video programmers, without regard to content. *See Video Dialtone Order, supra,* 7 F.C.C. Rcd. 5781 ¶¶ 141-143.

Pet. App. 47a-48a.

The FCC Order to which the Fourth Circuit refers offered only a brief analysis of the common carrier option to § 533(b). *Video Dialtone Order*, 7 FCC Rcd 5781, ¶¶ 141-143 (1992). The Commission suggested that the appropriate fraction of channels a telephone company could reserve for itself is on the order of 25 percent. *Id.* at ¶ 143 n.360. An earlier Staff Report had suggested that the appropriate fraction should be between 20 to 30 percent. JA at 68. According to the Staff Report, if the telephone company is allowed to have a larger share, say 80 percent, then it could retain some monopoly power that would allow it to cross-subsidize its video programming services. Alternatively, if its retained percentage were too low, say 5 percent, then the telephone company would have little incentive to build its new video transmission facilities in the first place. The 20-30 percent figure was the Staff Report's educated guess designed to split the difference between these two extremes.

The FCC has carefully expressed the telephone company's common carrier obligation as a *percentage* of the total system. If the telephone company could use some minimum guaranteed *number* of channels, then, according to the Staff Report, it would have a powerful

incentive to build a video transmission system just large enough to cover its own needs, just as any private operator would do. JA 68.

Simply stated, common carrier status is said to control the theoretical risk of cross-subsidy of video programming while permitting more telephone company speech than is possible under the § 533(b) ban. The implicit logic of this argument is this. The telephone company is required to build a system four times the size it needs for its own use. Any effort to subsidize that system would necessarily result in the telephone company granting three-quarters of the subsidy to independent programmers. The inability to keep most of the subsidy for itself would reduce whatever incentive the telephone company would have to create it in the first place. Since this common carrier alternative is less restrictive than the ban and, in the FCC's view, as effective in countering any alleged cross-subsidy risk, the Fourth Circuit concluded that the alternative helped to show that the ban is not sufficiently tailored to the cross subsidy concern, whatever its validity.

The constitutionality of this common carrier requirement was not litigated below. The Fourth Circuit did not examine this suggestion, which it made for only a limited purpose. "We cite the alternative not to imply its constitutionality, but only to show that Section 533(b) is itself unconstitutional." Pet. App. 48a n.34.

In *FCC v. Midwest Video Corp.*, 440 U.S. 689 (1979), this Court struck down a comparable but less onerous requirement that applied to cable operators. The FCC had ordered all cable systems over a certain size to expand their capacity from a then-average 12 channels to 20 channels, and to offer some of the new channels for public use on a common carrier basis. The Court invalidated the FCC's rules as contrary to a statutory requirement that cable service not be subject to common carrier regulation. *See* 47 U.S.C. § 541(c) ("Any cable system shall not be subject to regulation as a common carrier or utility by reason of providing any cable service."). The Court also noted that subjecting cable channels to common carriage came "at the expense of the journalistic freedom" of cable operators to compose their own package of programming. 440 U.S. at 707. "[E]ven when not occasioning the displacement of alternative programming, compelling cable operators indiscriminately to accept access programming will interfere with their determinations regarding the total service offering to be extended to subscribers." *Id.* at 707 n.17. The Court did not reach the First Amendment and Takings Clause issues presented by the FCC's rules, but noted that these were "not frivolous." *Id.* at 709 n.19.

More recently, the common carrier possibility for both cable and telephone companies was discussed in Justice O'Connor's concurring opinion in *Turner Broadcasting*, 114 S. Ct. at 2475, as an alternative to compelling cable operators to carry local broadcast channels:

> If Congress finds that cable operators are leaving some channels empty — perhaps for ease of future expansion — it can compel the operators to make the free channels available to programmers who otherwise would not get carriage. *See PruneYard Shopping Center v. Robins*, 447 U.S. 74, 88 (1980) (upholding a compelled access scheme because it did not burden others' speech). Congress might also conceivably obligate cable operators to act as common carriers for some of their channels, with those channels being open to all through some sort of lottery system or timesharing arrangement. Setting aside any possible Takings Clause issues, it stands to reason that if Congress may demand that telephone companies operate as common carriers, it can ask the same of cable companies; such an approach would not suffer from the defect of preferring one speaker to another.

Turner Broadcasting, 114 S. Ct. at 2480.

ARGUMENT

The main purpose of this brief is to show that the hesitation that the Fourth Circuit expressed about the unconstitutionality of the common carrier alternative and that Justice O'Connor expressed about possible Takings Clause issues is in fact well founded. Analyzed in some detail, it becomes clear that *in this context* common carrier regulation, whose details are still unknown but are irrelevant to the argument made in this brief, would place far too great a burden on First Amendment freedoms to withstand examination under the intermediate scrutiny standard of *Turner*. The conclusion is plain: Just as the First Amendment makes it impermissible for the FCC (under strict or intermediate scrutiny) to ban the telephone companies from providing video programming in their region, so too it prevents the FCC from conditioning the right of

telephone companies from entering that market on their willingness to accept some as yet unspecified form of common carrier status.

I. There Is No Compelling Reason for Common Carrier Regulation of the Video Programming Business

Historically, common carriage obligations have never been thrust upon private businesses without their consent. Instead, these obligations attach only after a firm decides voluntarily to enter a business that is subject to common carrier regulation. In this regard, it is instructive to note that the Communications Act of 1934 defines a common carrier as "any person engaged as a common carrier for hire, in interstate or foreign communication by wire or radio." 47 U.S.C. § 153(h). The regulations amplify that definition by stating that a communication common carrier is "[a]ny person engaged in rendering communication service for hire to the public." 47 C.F.R. § 21.2 (1994). The effect of these two definitions is to link the communications definition of a common carrier to its common law origins, and that in turn stresses the quasi-public nature of the undertaking: "the primary *sine qua non* of common carrier status is a quasi-public character, which arises out of the undertaking to carry for all people indifferently." *National Ass'n of Regulatory Util. Comm'rs v. FCC*, 533 F.2d 601, 608 (D.C. Cir. 1976) (internal quotation omitted). The key element of this definition is the "undertaking" by a given firm to serve all individuals. It is therefore possible for a single company to engage simultaneously in two types of business, one for common carriage, and the other directed toward particular customers only. *See Midwest Video Corp.*, 440 U.S. at 701 n.9 ("one can be a common carrier with regard to some activities but not others"). Thus in *Southwestern Bell Telephone Co. v. FCC*, 19 F.3d 1475 (D.C. Cir. 1994), the Court of Appeals held that the FCC could *not* regulate as common carriage a certain "dark fiber" service just because some telephone companies had provided it "as a limited, customer-specific service." 19 F.3d at 1481. Accordingly, the carriers were allowed to discontinue offering dark fiber service, without first receiving FCC approval.

The decision in *Southwestern Bell* fits in well with the basic logic of common carrier regulation. Food, clothing, and shelter are necessities of life, but they are not provided under a common carrier

regime that requires firms in these lines of endeavor to take all customers indifferently. The vast range of private alternatives provides consumers with all the protection that they need. The discontinuation of dark fiber service at issue in *Southwestern Bell* did not disrupt or impair the efficiency of the overall telephone network. As such that service was correctly treated as a private service, analogous to the wide variety of services found in ordinary markets. By way of parallel, the video programming services at issue in this case need not be regulated as common carriage to assure the operation of the telephone network, any more than dark fiber service needs to be so regulated. Video programming can be offered on a limited basis to select groups of customers, as in *Southwestern Bell*, and their possible discontinuation does not threaten the viability of the overall telephone network.

So understood, the present case illustrates the powerful economic logic behind the distinction between common carrier and private services. The core telephone transmission services of 1,000 separate telephone companies of all sizes and capacities have to be knitted together into a single cohesive network in order to facilitate the transmission of information from any point in the network to any other point in the network. In this environment, common carrier regulation ensures that telephone companies do not refuse service, or set price so high as to deter service, either to telephone users or connecting carriers. This regulation always carries with it the risk of confiscation, but that risk can be checked effectively by insisting that all carriers receive a just rate of return on the investments committed to their common carrier businesses. At the same time, such regulation need pose no threat to fundamental First Amendment values because it does not limit the speech of the telephone companies.

The same sunny view of common carrier regulation is not appropriate in the novel context of video programming services. Requiring the carrier to serve all customers at a regulated price has never been easy even for public utilities that face relatively stable demand for their outputs that are in turn produced by relatively stable technology. In the fast-moving video programming market, instability and innovation are the only permanent truths, and these conditions make it difficult to fashion reliable rates to reflect the rapid shifts on both the cost and the demand side of the market. Worse still, there is no guarantee that any channels built at telephone company expense and dedicated by law to common carrier status will be leased by other programmers, so that the telephone company could be left with the

worst of both worlds: sharp restrictions on its rate of return if the venture proves successful and demand is high, and no compensation from the Government if its common carrier lines lay vacant.

II. The Just Compensation Remedy for Idle Channels Is Not Clearly Available Under Current Takings Jurisprudence

One possible way to meet this difficulty is to insist that compensation be provided to the telephone companies if forced to construct expensive facilities that then remain idle. One plausible way to make this argument is to treat the United States as though it leased those vacant channels for its own purposes when it refuses to allow the telephone companies to use these channels themselves. By excluding the telephone companies from the use of their own property, it is as though the Government has taken possession of them. It must then pay compensation for the time it uses the channels in question, just as it must pay compensation when it occupies a building for an indefinite term of years against the will of its owner. *See, e.g., General Motors v. United States,* 323 U.S. 373 (1945).

It is, however, an open question whether this compensation claim would be honored by the Government, or indeed accepted by the Court. The precise question of whether an exclusion from the possession of some portion of the system constitutes a taking is not settled under this Court's takings jurisprudence. It is not crystal clear whether the requirement that certain channels be left vacant will be treated as a physical taking, for which there is a virtual per se rule of compensation, *see Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982), or in the alternative whether it will be regarded as part of a regulatory initiative for which compensation is required only when the regulation denies the owner of the property (presumably the entire facility) any "economically viable" use. *See Lucas v. South Carolina Coastal Council,* 112 S. Ct. 2886 (1992).

Both these tests raise formidable difficulties of their own. *Loretto*, for example, involved the permanent physical occupation of space that is strongly analogous to the "electronic occupation" that occurs when a telephone company's computers and cables are forced either to carry the video programming of others or sit idle. But the *Loretto* definition of physical taking has not been uniformly applied. In *Yee v. City of Escondido,* 503 U.S. 519 (1992), the occupation of a pad by a mobile

home tenant was held to be "a regulation of petitioners' *use* of their property, and thus does not amount to a *per se* taking." *Id.* at 532 (emphasis in original). And that same conclusion was held to follow from the fact that the landowners chose to "voluntarily open" their premises to others.

In our view, the forced idleness of particular property should be treated as a physical taking, compensable for the full period of its duration. It is not credible to assert that a telephone company's decision to build four times the needed video transport capacity is "voluntary" when the FCC has mandated such excess construction as the price of the telephone company's video speech. Even if the forced idleness is regarded only as a regulatory taking, the better view treats the period of idleness separately. Since no revenues have been collected for that period, explicit compensation from the Government should be required to make up the Government-created shortfall. In rate regulation generally it is improper to reduce the recovery allowed in the current period to reflect some larger than anticipated gains made in some previous rate period. "Past losses cannot be used to enhance the value of the property or to support a claim that rates for the future are confiscatory. And the law does not require the company to give up for the benefit of future subscribers any part of its accumulations from past operations." *Board of Public Utility Comm'rs v. New York Telephone Co.*, 271 U.S. 23, 31-32 (1926) (citation omitted).

III. The Absence of Clear Protection Against Forced Idleness of Common Carrier Video Programming Channels Will Retard Telephone Company Entrance into the Field

For these purposes, however, it is not necessary to reach a definitive resolution of a difficult takings question. The critical point is to note the cautious legal advice on the compensation question that must be given to a telephone company that wished to operate its own video programming facility. There is no way that such a company could be assured that compensation for its idle channels would be required under present law. The lack of clarity of the just compensation question thus lends additional urgency to the telephone company's First Amendment claim that unsettled policies effectively silence its right to speak. The very uncertainty of the status of the compensation remedy only underscores the legal risks that any telephone company would bear

in committing its resources to such a hazardous business venture. Does it take the risk that the government will refuse to pay compensation for the rental value of vacant channels? That it will offer some inadequate compensation? What are the costs of future litigation if disputes arise, and the possibilities of success?

Nor are these difficulties obviated by trying to take the idle capacity into account in ratemaking procedures. Here, it is conceivable that the FCC or state regulators could allow a telephone company to set rates high enough to recoup the lost revenues in some future period. But once again, there is no guarantee that this form of deferred compensation will provide any effective relief to the telephone companies. It is one thing for the regulator to allow certain rates. It is quite another for the market to pay those rates. Should a demand emerge for the once vacant channels, no potential customer in a competitive market will pay for the downtime of the channel prior to its own use. Those costs are sunk and hence cannot be recovered. Thus, the telephone companies would face this unpleasant dilemma. If the FCC sets the rates too low, the telephone company has no choice but to lease channels at those reduced levels. But if it sets them too high, then potential lessees will simply refuse to deal unless they receive price concessions. The telephone companies can lose from regulation but not gain.

The scope of the government intrusion, it should be evident, is much greater than the intrusion inflicted on the mall owner in *PruneYard Shopping Center v. Robins*, 447 U.S. 74 (1980). In *PruneYard* the mall owner did not attack, and this Court did not address, the protester's intrusion on the ground that it was forced to subsidize speech to which it was opposed. Accordingly, this Court allowed the protesters' activities for reasons that are inapplicable here. The mall owner could not make a credible showing that its patrons would confuse the message of the protesters with the views of the mall owner; and the Court found no evidence in the record to indicate that the presence of protesters in the Mall would cause any economic loss to the mall owner's operations. In contrast, the burdens of common carrier status on a telephone company are far greater. In this context, every channel that is used by lessees is a channel that is not available to the owner of the facility. Every decision to commandeer resources reduces the likelihood that the facility will be produced in the first place. Here the required lessees and the telephone company are in the same video programming business, so that the risk of confusion of

messages and consequent loss of advertising and good will is far greater. That greater negative impact of government regulation means that this common carrier system for video programming fails under a standard of intermediate scrutiny.

The basic point here can be made by yet another analogy if we step back from the fast-paced world of telecommunications. Ordinary office and housing markets contain both leased and owner-occupied facilities. There is little reason to think that sensible firms operating in a competitive market cannot decide whether to pursue ownership or lease. If certain rooms lay vacant and may be needed for future expansion, the sensible owner can decide whether to hold them off the market, to rent them on a short term lease at a below-market price, or to rent them on a long-term lease at a higher price reserving to itself a buyback option. No system of rent control could do better for that owner or his potential tenant (who wants the unit to be available in the first place) than their combined voluntary choices, for no outsider has information about the needs of the two parties superior to that they themselves possess. It would be odd in the extreme therefore for the State to tell any landowner, "we will let you build a home for yourself so long as you occupy only one unit in a four unit complex" (to get the desired 25 percent ratio). It is more than odd to impose that requirement on a video programmer that has explicit First Amendment protection. The obligations that are contemplated by this common carrier suggestion are onerous even if ideally implemented and suffocating if not. The huge level of uncertainty associated with any such program means that this Court should look on the proposal with deep suspicion. It should not preserve § 533(b) by looking to unknown systems of common carrier regulation with distinctive pitfalls of their own.

Justice O'Connor's modest suggestion in *Turner* that "Congress *might* . . . *conceivably* obligate cable operators to act as common carriers for *some* of their channels" (114 S. Ct. at 2480 (emphasis added)) is not to the contrary. In addition to the just compensation issues that she has identified, another First Amendment issue is also raised. Justice O'Connor thought that her proposal could be subject to a reduced standard of review because it "would not suffer from the defect of preferring one speaker to another." *Id.* But in the context of this litigation, that condition would no longer be satisfied when both telephone companies and cable companies compete in the same market. The FCC's proposal to saddle telephone companies — and only

telephone companies — with a common carriage requirement explicitly prefers one speaker to another. By exempting the cable companies who wield monopoly power in video distribution and imposing the common carriage requirement only on new entrant telephone companies, the FCC is deterring competition and unfairly and selectively burdening the video speech of telephone companies such as East Ascension Telephone that would not voluntarily elect common carrier regulation.

CONCLUSION

The FCC should not be permitted to salvage § 533(b) by appealing to an unknown and untested system of common carrier regulation for video programming. Here is yet another case where the simple solution is best. Section 533(b) should be struck down. If Congress or the FCC wishes to regulate anew in this area, they may do so, but only subject to the constraints of the First and Fifth Amendments.

Accordingly, the decision below should be affirmed.

Respectfully submitted.

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IN THE

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v.

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On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF OF U S WEST, INC. AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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---

BRIEF OF U S WEST, INC. AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

U S WEST, Inc. ("U S WEST") respectfully submits this brief as *amicus curiae* in support of respondents, urging affirmance of the decision below. Written consents of all parties to the filing of this brief have been filed with the Clerk pursuant to Supreme Court Rule 37.3.

INTEREST OF THE *AMICUS CURIAE*

U S WEST and its subsidiaries and affiliates provide local telephone service to customers in 14 western states with a total population of more than 30 million people. U S WEST wishes to provide cable television service, in competition with existing cable operators, within this 14-state regon, but 47 U.S.C. 533(b) ("section 533(b)"), if valid, would by its terms prohibit U S WEST from doing so.

U S WEST, joined by other local telephone companies, brought suit against the federal petitioners in the U.S. District Court for the Western District of Washington, seeking to establish its right under the First Amendment to provide such video programming. The district court granted summary judgment for the plaintiffs, holding that section 533(b) unnecessarily "sacrifices" the First Amendment rights of U S WEST and other telephone companies because it is not narrowly tailored to serve any substantial governmental interest. *U S WEST, Inc.* v. *United States*, 855 F. Supp. 1184, 1193 (W.D. Wash. 1994).

The Ninth Circuit affirmed, concluding for similar reasons that section 533(b) violates the First Amendment. *U S WEST, Inc.* v. *United States*, 48 F.3d 1092 (9th Cir. 1995). Judge Hall, writing for a unanimous panel, first determined that the video programming ban should be subjected to intermediate scrutiny in light of this Court's decision in *Turner Broadcasting System, Inc.* v. *FCC*, 114 S. Ct. 2445 (1994). *See* 48 F.3d at 1097-100. She then concluded that there was no evidence to support two "interests" proffered by the Government as reasons for sustaining section 533(b): to prevent telephone companies from limiting access to poles and conduits, and to promote diversity by preventing telephone companies from monopolizing the cable television industry. *Id.* at 1102-03. As for a third argument—that the video programming ban reduces incentives for telephone companies to "cross-subsidize" cable operations by shift-

ing costs to regulated telephone operations—the court found that although there was a question whether the statute serves this purpose at all, there was no doubt that section 533(b) is not narrowly tailored to meet such a concern. *Id.* at 1103-06. Citing several examples of steps the Government could take, short of a sweeping ban on speech, to prevent anti-competitive behavior such as cross-subsidization, the court held that section 533(b) is not narrowly tailored and thus fails First Amendment scrutiny. *Id.* at 1104-06. The court also firmly rejected the Government's argument that Congress, in not repealing section 533(b), implicitly made legislative findings to which the court should defer. *Id.* at 1100-01, 1106. The court of appeals refused to accept "congressional *inaction* as persuasive evidence . . . of Congress's having 'found' anything." *Id.* at 1106.

For similar reasons, in the present case, the Court of Appeals for the Fourth Circuit held that section 533(b) violates the First Amendment. Eight other district courts have also concluded that the video programming ban is unconstitutional, and no court has held to the contrary. *See* Response to Petitions for Writ of Certiorari 4 n.2 (listing cases). U S WEST, like respondents, has an interest in offering video programming in its local telephone service area. U S WEST submits this brief in support of respondents' position that prohibiting this speech activity violates the First Amendment.

STATEMENT OF THE CASE

We adopt respondents' statement of the case. However, because this brief focuses in part on the FCC's *Third Report and Order*,[1] we briefly summarize it here. The *Third Report and Order* is reprinted in the Appen-

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[1] *Telephone Company—Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Third Report and Order*, 10 FCC Rcd 7887 (1995), petition for review filed *sub nom. GTE California Inc.* v. *FCC*, No. 95-70518 (9th Cir. June 28, 1995).

dix to the Supplemental Brief of Petitioners in Support of Petition for a Writ of Certiorari ("Pet. Supp. App." 1a-21a).[2]

In the *Third Report and Order*, the FCC reinterpreted section 533(b)'s "good cause" waiver provision, saying it was doing so in order to avoid the "serious question as to whether Section [533](b) unnecessarily burdens substantially more speech than is necessary to promote competition in the multi-channel video programming market." Pet. Supp. App. 6a. The waiver provision states that "upon [a] showing of good cause, the Commission may, on petition for waiver, waive the applicability of" the telephone company in-region video programming bar. 47 U.S.C. 533(b)(4). Before granting a waiver, the FCC must find that "the issuance of such waiver is justified by the particular circumstances demonstrated by the petitioner, taking into account the policy of this subsection." *Id.*

Until the *Third Report and Order*, the agency had found "good cause" to support a waiver only where the applicant could "demonstate" that the waiver was needed and would serve the public interest in that "particular case[]." *Revision of the Processing Policies for Waivers of the Telephone Company—Cable Television Cross Ownership Rules*, 69 F.C.C.2d 1097, 1111 (1978). Under the new regime announced in the *Third Report and Order*, the FCC has determined that "good cause" now exists to grant waivers more broadly, because "the cable industry has grown from a fledgling service to a more mature industry that now serves a majority of households" and thus, in the agency's view, the "relevant circumstances

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[2] "Gov't Br." refers to the Brief for the Federal Petitioners. "NCTA Br." refers to the Brief for Petitioner National Cable Television Association, Inc. "Pet. App." refers to the appendix to the petition for certiorari in No. 94-1893. "J.A." refers to the Joint Appendix.

have changed greatly since" the adoption of the telephone company video programming ban. Pet. Supp. App. 11a.

The agency did not, however, conclude that the statute required it to grant a waiver automatically to every interested telephone company; nor did it clearly set forth the circumstances in which waivers will be granted. The FCC simply determined that it was authorized to use its discretion to grant waivers, *id.* at 17a, and it announced a policy of granting waivers where it finds that a telephone company has agreed "to abide by the regulations [the FCC] *will* establish governing [the] provision of video programming." *Id.* at 19a (emphasis added). The agency did not state specifically what those future regulations will be, merely announcing that waivers will be "subject to . . . any further rules we will enact." *Id.* at 20a. Although the FCC indicated that telephone companies might be allowed to provide video programming over video dialtone systems that "include[] a common carriage element," *id.* at 13a, the agency expressly declined to decide, for example, what regulatory regime will apply, *id.* at 3a, or whether a telephone company will be allowed "to build a traditional cable system in its telephone service area in competition with an existing cable service." *Id.* at 17a n.46.

SUMMARY OF ARGUMENT

The court of appeals (and the Ninth Circuit in the *U S WEST* case) ruled that section 533(b) cannot survive intermediate First Amendment scrutiny because its blanket ban on in-region provision of video programming is too broad to serve any proffered governmental purpose. In this Court, petitioners make two arguments for reversal:

1. The courts should defer to supposed congressional findings that the blanket ban is necessary to prevent cross-subsidization and that no lesser regime will suffice.

2. In any event, the FCC has cured the lack of narrow tailoring by announcing that it will interpret the statute's "good cause" waiver provision expansively so as to allow telephone companies to provide some in-region video programming (albeit under conditions that have not yet been fully specified).

Each of these arguments is flawed, and each fatally undercuts the other. As to the first argument, the legislative record does not support petitioners' claim that Congress found that a complete ban on video programming is necessary to prevent cross-subsidization. No such finding is explicit or implicit in the 1984 enactment of the statute, and no such finding may properly be inferred from subsequent congressional inaction. Moreover, petitioners ignore the most recent congressional activity concerning the need for a blanket ban: the passage in both Houses of bills that would repeal section 533(b). Finally, the FCC's *Third Report and Order*, which describes sweeping changes in circumstances and begins to construct a new regulatory regime based on broad waivers to allow telephone companies to provide video programming on "video dialtone" platforms, completely undercuts the same agency's argument to this Court that Congress sees a continuing need for a complete ban.

As to the second argument, the FCC cannot save section 533(b) from invalidation by changing its own waiver policy. Courts and agencies have, in some cases, saved statutes from First Amendment attack by construing their substantive provisions to avoid a constitutional issue. Petitioners invoke such cases here, but that is not at all what the FCC has done in this instance. Under the *Third Report and Order*, telephone companies would remain subject to an unconstitutional blanket statutory ban on a protected form of speech. The FCC has said only that it intends, as a matter of administrative grace, to forgive compliance in some situations. This agency action does

not make the statute itself any more constitutional than before, and it does not moot the constitutional issue because the agency forgiveness is at best partial, subject to conditions not yet fully defined, and subject to change. Indeed, unbridled FCC discretion to dole out otherwise prohibited speaking opportunities would only make the situation worse.

ARGUMENT

I. THE VIDEO PROGRAMMING BAN IS NOT NARROWLY TAILORED TO MEET ANY PROFFERED GOVERNMENTAL INTEREST, AND CONGRESS HAS NEITHER EXPLICITLY NOR IMPLICITLY FOUND THAT THE BAN IS NECESSARY

A. There Has Been No Congressional Finding That a Complete Ban on Telephone Company Provision of Video Programming Is Necessary To Serve the Interests Proffered by the Government

The Government concedes that section 533(b) "completely exclud[es] [telephone companies] from cable programming in their service areas." Gov't Br. 25. The Government claims, however, that this complete ban survives intermediate scrutiny because it is narrowly tailored to prevent cross-subsidization by telephone companies entering the cable television market.[3] To the contrary, every

[3] The Government also contends that the video programming ban is necessary to prevent telephone companies from "abusing their control" over poles and conduits and telephone networks. Gov't Br. 35-37. But this "pole access" argument fails at the threshold. The Government relies on the FCC's statement *in 1970* that it was adopting the rule later codified as section 533(b) out of concern that telephone companies might use their control over utility poles and conduits to hinder the development of an independent cable television industry. *Id.* at 35. But by 1981, three years *before* Congress adopted section 533(b), the FCC's Office of Plans and Policy had already concluded that such concerns did not justify the video programming ban. *FCC Policy on Cable Ownership: A Staff Report* 162 (1981) (J.A. 160-61). The FCC strongly re-

expert federal agency that has examined the question, including both the FCC and the Department of Justice, has concluded that much more limited—and better targeted—regulatory safeguards than a complete ban on video programming can meet any risk of cross-subsidy.

For example, when the FCC formally recommended the repeal of section 533(b) in its 1992 *Video Dialtone Order*, it explicitly concluded that existing regulatory safeguards, such as detailed cost allocation and accounting rules,[4] regulations ensuring equal treatment of non-regulated services provided over telephone networks,[5] and the development of "price cap" regulation,[6] were "sufficient . . . to protect against cross-subsidization." 7 FCC Rcd 5781, 5828-29 (1992). The FCC's *Third Report and Order*, discussed in detail below, dramatically reiterates the FCC's determination that regulatory safeguards would provide ample protection against any potential for cross-subsidization. The Antitrust Division of the Justice Department agrees that concerns about anticompetitive

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affirmed this position in its 1992 *Video Dialtone Order*, finding that the passage of the Pole Attachment Act of 1978, 47 U.S.C. 224 (b)(1), and the cabling of almost the entire country had long ago rendered such concerns obsolete. *Telephone Company—Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking*, 7 FCC Rcd 5781, 5849 (1992), modified in part on recon., 10 FCC Rcd 244 (1994), petition for review filed *sub nom. Mankato Citizens Telephone Co.* v. *FCC*, No. 92-1404 (D.C. Cir. Sept. 9, 1992). For these reasons, and because section 533(b) does not prohibit the provision of video transport services, the Ninth Circuit found no evidence to support this rationale for the statute. *U S WEST*, 48 F.3d at 1102-03.

[4] *See Southwestern Bell Corp.* v. *FCC*, 896 F.2d 1378 (D.C. Cir. 1990).

[5] *See California* v. *FCC*, 39 F.3d 919 (9th Cir. 1994), cert. denied, 115 S. Ct. 1427 (1995).

[6] *See National Rural Telecom Ass'n* v. *FCC*, 988 F.2d 174, 178 (D.C. Cir. 1993).

behavior do not justify retaining section 533(b).[7] The National Telecommunications and Information Administration (NTIA) at the Department of Commerce has similarly concluded that such concerns are "either overstated or can be effectively ameliorated by adapting existing regulatory safeguards to suit the video programming marketplace."[8]

Because the expert agencies have long since concluded that section 533(b) is not needed to prevent cross-subsidization, the Government falls back on a deference argument: "*Congress* reasonably concluded that the cross-ownership bar is necessary to prevent cross-subsidization by [telephone companies] in the cable market effectively." Gov't Br. 31 (emphasis added). The Government then asks the Court to defer to this supposed congressional "judgment." *Id.* at 28-29; *see id.* at 32 n.21. Similarly, petitioner NCTA asserts that "there is no adequate basis for the judiciary to set aside *the congressional judgment* on the issue here." NCTA Br. 44 (emphasis added).

The lower courts, including the Ninth Circuit in the *U S WEST* case, have firmly rejected this call for deference because there is simply no reason to believe that Congress ever made—in formal findings or anywhere else—any such "judgment." When Congress passed section 533(b) in 1984, it codified, essentially without comment, an FCC rule adopted in 1970 for the infant cable industry out of concern that telephone companies might "preempt the market for [cable television] service."[9] The

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[7] Reply Comments of the U.S. Department of Justice, *Telephone Company—Cable Television Cross-Ownership Rules* 44 (Mar. 13, 1992) (J.A. 341-42).

[8] NTIA, U.S. Dep't of Commerce, *The NTIA Infrastructure Report: Telecommunications in the Age of Information* 235 (1991) (J.A. 343).

[9] *Applications of Telephone Companies for Section 214 Certificates for Channel Facilities Furnished to Affiliated Community Antenna Television Systems, Final Report and Order*, 21 F.C.C.2d

1984 Congress made no relevant findings of fact in the statute itself, and the single reference to section 533(b) in the legislative history merely explains that Congress intended to codify the earlier FCC rule.[10] (This case is thus unlike *Turner Broadcasting*, which involved a statutory provision supported by "unusually detailed statutory findings." 114 S. Ct. at 2461; *see id.* at 2454-55, 2469.) Moreover, there is no indication that Congress even considered, and no reason whatever to assume that it reached any judgment about, the problem of cross-subsidization; the supposition that cross-subsidization can be effectively prevented only by a complete ban, and not by less severe regulatory alternatives, is a litigator's supposition that there is no basis whatever for attributing to Congress. *See U S WEST*, 48 F.3d at 1100-01, 1106. As the D.C. Circuit recently concluded after a thorough examination of section 533(b) and its legislative history, "Congress itself has never embraced [this] purpose[] as its own." *American Scholastic TV Programming Foundation* v. *FCC*, 46 F.3d 1173, 1182 (D.C. Cir. 1995).[11]

307, 324 (1970), aff'd *sub nom. General Telephone Co.* v. *United States*, 449 F.2d 846 (5th Cir. 1971).

[10] H.R. Rep. No. 934, 98th Cong., 2d Sess. 56 (1984). Another passage describes section 533 as a whole as intended "to prevent the development of local media monopolies, and to encourage a diversity of ownership of communications outlets." *Id.* at 55. Logically, this reference must have pertained to other portions of section 533, such as a broadcast station/cable cross-ownership ban and a later-deleted newspaper/cable cross-ownership ban, because a common carrier telephone service is *not* a medium or "outlet" for owner communications. Telephone companies carry third-parties' messages from one customer to another. *See U S WEST*, 855 F. Supp. at 1187. In any event, this statement of the general purposes behind section 533 does not imply a congressional judgment that a total ban on video programming is necessary to prevent any particular phenomenon.

[11] The petitioners in *American Scholastic*, like the Government here, argued that the purposes of section 533(b) are to prevent problems with pole access and to prevent cross-subsidization. The

Given the admittedly "sparse" legislative history, NCTA Br. 32, petitioners are forced to argue that the failure of Congress since 1984 to repeal section 533(b) amounts to a congressional "judgment" that nothing short of a complete ban will suffice. The Government points to hearings and staff reports on proposals to repeal section 533(b) that never made it out of committee as evidence that Congress as a whole—sometime after 1984—decided to reject less restrictive regulatory alternatives to a complete ban. *See* Gov't Br. 8-11, 31-34; NCTA Br. 16-17, 35 n.28. But this Court has repeatedly rebuffed efforts to divine legislative judgments from Congress's failure to act, explaining that "Congressional inaction lacks persuasive significance because several equally tenable inferences may be drawn from such inaction." *Pension Benefit Guarantee Corp.* v. *LTV Corp.*, 496 U.S. 633, 650 (1990) (internal quotation marks and citation omitted); *see Central Bank* v. *First Interstate Bank*, 114 S. Ct. 1439, 1453 (1994). Congress's failure to repeal section 533(b) in the last decade, in the face of dramatic changes in the cable television market and findings by the relevant expert agencies that the statute unnecessarily limits competition and diversity, says nothing about Congress's attitude toward less draconian alternatives. As the district court concluded below: "[N]owhere in the legislative materials is there any indication that Congress reached a conclusion concerning the effectiveness of less restrictive regulatory measures." Pet. App. 100a; *accord U S WEST*, 48 F.3d at 1106.

If congressional views, unembodied in enacted legislation, were a proper basis for determining whether particular legislation is needed to solve an alleged problem, then the best evidence of Congress's present views would be the recent passage, by both Houses, of bills that would repeal section 533(b). Petitioners' recitations of the

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court found that Congress "has never in law or legislative history specifically adopted these purposes." 46 F.3d at 1182.

"subsequent legislative history" of section 533(b) end prematurely in 1992, *see* Gov't Br. 8-11; NCTA Br. 15-17, omitting what is clearly the most important evidence of Congress's views. In 1994, the House of Representatives approved by a vote of 423 to 4 a bill (H.R. 3636) that would have repealed section 533(b), 140 Cong. Rec. H5247-48 (daily ed. June 28, 1994), and the committee report accompanying the bill declared that the rationale for a video programming ban was "no longer valid." H.R. Rep. No. 560, 103d Cong., 2d Sess. 47 (1994). Senate committees also approved several bills in 1994 that would have repealed section 533(b). *See, e.g.*, S. Rep. No. 367, 103d Cong., 2d Sess. (1994) (reporting S. 1822).

Once again this year, Congress is working on legislation that would repeal the video programming ban. In June, the full Senate passed by a vote of 81 to 18 a bill (S. 652) that would repeal section 533(b) and allow telephone companies and their affiliates to provide video programming either through a cable system as a traditional cable operator or though a video dialtone system.[12] 141 Cong. Rec. S8480 (daily ed. June 15, 1995). In August, the House of Representatives passed a similar bill (H.R. 1555), which would allow telephone companies (through affiliates) to provide video programming directly to local subscribers through either cable systems or video dialtone platforms.[13] 141 Cong. Rec. H8506-07

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[12] The Government's description of the Senate bill as allowing telephone companies "to offer video programming through video dialtone systems," Gov't Br. 16 n.12, is misleadingly terse. The bill would also allow a telephone company to provide in-region video programming as a traditional cable operator, without creating a video dialtone system. *See* S. 652, 104th Cong., 1st Sess. § 202(a).

[13] The Government's description of the House bill is also inaccurate. The Government states that H.R. 1555 would allow telephone companies "to offer video programming to subscribers in their service areas, through video dialtone platforms operated by separate affiliates." Gov't Br. 16 n.12. In fact, as passed by the House, H.R. 1555 would also allow telephone companies to offer

(daily ed. Aug. 4, 1995) (approved by a vote of 305 to 117). The committee report on the bill declares that "[t]elephone company competition with the entrenched cable operators would enable consumers to benefit from lower rates, better quality service, improved maintenance, and a larger diversity of new information services." H.R. Rep. No. 204, 104th Cong., 1st Sess. 53 (1995). These recent legislative developments refute the Government's contention that Congress has failed to repeal section 533(b) because it has a "judgment" that regulatory alternatives short of a complete video programming ban would not be adequate to prevent cross-subsidization.

Of course, "Congress is not obligated, when enacting its statutes, to make a record of the type that an administrative agency or court does to accommodate judicial review." *Turner Broadcasting*, 114 S. Ct. at 2471 (plurality opinion). But when the Government seeks to defend a broad statutory ban on speech, deemed unnecessary and counterproductive by all the expert agencies, by arguing that all these views are trumped by a congressional judgment that no lesser restriction will suffice, the Government must at least show that Congress actually made such a judgment. The Government's lawyers may not simply posit a problem and then claim that Congress, by adopting a sweeping restriction on speech (without explanation) and then failing to repeal it, must have decided that the infringement on speech is necessary to meet the problem posited. *See id.* at 2470 (plurality opinion); *Los Angeles* v. *Preferred Communications, Inc.*, 476 U.S. 488, 496 (1986) ("This Court may not simply assume that the ordinance will always advance the asserted state interests sufficiently to justify its abridgement of expres-

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video programming through separate affiliates acting as traditional cable operators. H.R. 1555, 104th Cong., 1st Sess. § 201. In addition, the bill would allow telephone companies, under certain conditions, to obtain a waiver from the requirement of using a separate video programming affiliate. *See id.* § 201(b).

sive activity") (internal quotation marks and citation omitted).

Moreover, even if Congress had judged it necessary to impose a sweeping ban on speech to address the issue of cross-subsidization, it remains the Court's responsibility "in the end to decide whether Congress has violated the Constitution." *Sable Communications, Inc.* v. *FCC*, 492 U.S. 115 (1989). For that reason, "[d]eference to a legislative finding cannot limit judicial inquiry when First Amendment rights are at stake." *Landmark Communications, Inc.* v. *Virginia*, 435 U.S. 829, 843 (1978). This principle was dramatized in the *Turner Broadcasting* case, where this Court vacated the lower court's judgment that the "must-carry" provisions of the 1992 Cable Act were constitutional despite the presence of extensive findings of fact supporting the must-carry rules in the text of the Act itself. *See* 114 S. Ct. at 2454-55; *id.* at 2470-72 (plurality opinion). As the Government acknowledges, it carries the burden of proving that "Congress has drawn reasonable inferences based on substantial evidence." *Turner Broadcasting*, 114 S. Ct. at 2471 (plurality opinion); *see* Gov't Br. 32 (quoting *Turner Broadcasting*). In this case, that burden is insurmountable, because the Government has neither the substantial evidence nor any basis for concluding that Congress actually drew the supposed inferences.

B. The FCC's *Third Report and Order* on Telephone Company Provision of In-Region Video Programming Fatally Undercuts the Argument That Congress Has Determined That a Blanket Ban Is Necessary

To prevail, the Government must prove that section 533(b) does not "burden substantially more speech than is necessary to further the government's legitimate interests." *Ward* v. *Rock Against Racism*, 491 U.S. 781, 799 (1989); *see Turner Broadcasting*, 114 S. Ct. at 2469 (quoting *Ward*); *id.* at 2470, 2472 (plurality opinion).

If there are "constitutionally acceptable less restrictive means of achieving the Government's asserted interests," *id.* at 2472 (plurality opinion) (internal quotation marks and citation omitted), then the statute is not narrowly tailored. The Government may not ignore "alternative, less drastic measures" by which it could protect its asserted interests in favor of a broad ban on speech. *City of Cincinnati* v. *Discovery Network, Inc.*, 113 S. Ct. 1505, 1510 n.13 (1993).

Even before the FCC's *Third Report and Order*, the Commission, along with every other expert telecommunications agency, had concluded that regulatory safeguards fully addressed the cross-subsidy concerns proffered by petitioners in their attempt to justify section 533(b). The FCC has now not only stated that less restrictive regulatory safeguards can meet these concerns, it has decided that it will not enforce the blanket ban but instead will rely on such less severe measures. These FCC actions speak more loudly than its litigators' words.

According to the FCC, "[t]he relevant circumstances have changed greatly" since the Commission adopted the ban in 1970 and Congress codified it in 1984. Pet. Supp. App. 11a. As Congress found in the 1992 Cable Act, cable operators enjoy a firmly entrenched monopoly in most communities;[14] telephone companies cannot prevent the development of a viable and independent cable industry. *Id.* In addition, "significant advances in technology" have "made it possible for a multitude of programmers to reach end user[s]" and have "mitigated" the concerns about competition that originally led to the adoption of the video programming ban. *Id.* at 11a-12a. The dramatic changes noted by the FCC would eliminate

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[14] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, § 2(a)(2), 106 Stat. 1460.

the basis for any congressional judgment about regulatory alternatives that might have been made in 1984.[15]

Contrary to its litigation position in this Court, the FCC has concluded that under present conditions telephone companies should provide in-region video programming, subject to regulatory safeguards. According to the FCC, Congress intended when it adopted section 533(b) " 'to promote competition.' " Pet. Supp. App. 10a (quoting *NCTA* v. *FCC*, 914 F.2d 285, 287 (D.C. Cir. 1990)). If excluding one class of speakers ever promoted competition or a diversity of voices, today there is no doubt that it "promote[s] competition to allow a telephone company to provide video dialtone service in its telephone service area in competition with an existing cable company." *Id.* at 17a. The FCC "has developed a number of safeguards that are designed to prevent cross-subsidization and discrimination," *id.* at 14a n.35, and these safeguards provide a more narrowly tailored alternative to the complete ban in section 533(b).

In *Turner Broadcasting*, this Court vacated and remanded the lower court's decision because, among other reasons, "the record fail[ed] to provide any judicial findings concerning the availability and efficacy of 'constitutionally acceptable less restrictive means' of achieving the Government's asserted interests." 114 S. Ct. at 2472 (plurality opinion) (quoting *Sable Communications*, 492 U.S. at 129). In this case, the lower courts have made the necessary findings about the availability of less restrictive, better targeted means of addressing the Government's concerns. The court of appeals below, for example, found at least one "obvious, less-burdensome" alternative: Con-

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[15] The Government bears the burden of showing that the statute is constitutional under *present* circumstances, for even a " 'statute [constitutionally] valid when enacted may become invalid by change in the conditions to which it is applied.' " *Baker* v. *Carr*, 369 U.S. 186, 254 n.6 (1962) (quoting *Nashville, Chattanooga & St. Louis Ry.* v. *Walters*, 294 U.S. 405, 415 (1935)).

gress could limit the telephone companies' editorial control over video programming to a fixed percentage of the channels available. Pet. App. 47a-48a. The Ninth Circuit in *U S WEST* also found "substantial evidence tending to show that the procompetitive goals of § 533(b) can currently be achieved through a variety of less speech-restrictive means." 48 F.3d at 1105. That court noted many possibilities in the record, including structural separation requirements short of a complete ban, nonstructural safeguards such as cost allocation and accounting rules, requiring telephone companies to carry unaffiliated video programming (the alternative noted by the Fourth Circuit), and strictly enforcing general antitrust laws.

Since then, the FCC has essentially agreed with the lower courts—it has endorsed "obvious, less-burdensome" alternatives to a complete ban, better tailored to meet any concerns about cross-subsidization. Pet. Supp. App. 3a-6a. The FCC's conclusion reflects the Government's failure to create any record justifying the need for the broad ban on speech contained in section 533(b). As Justice O'Connor remarked in *Turner Broadcasting*: "If the Government wants to avoid fraudulent political fundraising, it may bar the fraud, but it may not in the process prohibit legitimate fundraising." 114 S. Ct. at 2479 (O'Connor, J., concurring in part and dissenting in part) (citing *Schaumberg* v. *Citizens for a Better Environment*, 444 U.S. 620 (1980), and *Edenfield* v. *Fane*, 113 S. Ct. 1792 (1993)). So too here—if the Government wants to avoid anticompetitive behavior, it may bar such behavior, but it may not in the process prohibit legitimate telephone company speech.

II. THE FCC's NEW INTERPRETATION OF ITS WAIVER AUTHORITY IN THE *THIRD REPORT AND ORDER* ONLY EXACERBATES THE STATUTE'S UNCONSTITUTIONALITY

A. The FCC's New Construction of the "Good Cause" Waiver Provision Does Not Alter Section 533(b)'s Unconstitutional Blanket Ban on Telephone Company Provision of In-Region Video Programming

In plain language, section 533(b) bars telephone companies from providing video programming to subscribers in their telephone service areas. The statute states unequivocally that it "shall be unlawful" for a telephone company "to provide video programming directly to subscribers" or to provide "channels of communications" to an entity that it controls if those channels are "to be used for, or in connection with, the provision of video programming directly to subscribers in the telephone service area of the common carrier." 47 U.S.C. 533(b)(1), (2). The Government's own description of section 533(b) is that it "completely exclude[s] [telephone companies] from cable programming in their service area." Gov't Br. 25. As respondents and supporting *amici* have amply demonstrated, and the lower courts have unanimously concluded, this blanket ban unconstitutionally restricts speech.

Petitioners, invoking cases like *NLRB* v. *Catholic Bishop of Chicago*, 440 U.S. 490 (1979), argue that the FCC has recently found a "saving" construction of the statute that "eliminates the constitutional objections to the statutory regime." Gov't Br. 39; *see* NCTA Br. 26-34; Gov't Br. 39-43. But the FCC has done no such thing. As the *Third Report and Order* makes clear, the FCC has *not* given the substantive provisions of section 533(b) a narrowing construction that eliminates the unconstitutional restriction on telephone company speech.[16]

[16] The Commission acknowledges that section 533(b) "prohibits a telephone company from operating a cable system where it has

The FCC has merely (i) construed its own "good cause" waiver authority under section 533(b)(4) broadly and (ii) expressed an agency policy determination that it will henceforth exercise that authority generously.[17] This FCC action does not free telephone companies from the unconstitutional statutory ban; it merely promises freedom to speak, in circumstances not yet specified, as a matter of agency grace. The FCC says only that "telephone companies may seek a waiver of the statutory restriction in order to provide programming directly to subscribers over video dialtone facilities where they have a monopoly on local exchange telephone service." Pet. Supp. App. 15a. As NCTA explains, "the Commission's construction of Section 533(b)(4) will leave the presumptive statutory bar in place for all telephone companies that, though they may wish otherwise, fail to act in accord with the behavioral requirements made conditions of the waiver." NCTA Br. 32.

Petitioners invoke the general principle that courts engaged in statutory interpretation should attempt, when choosing among reasonable alternatives, to construe statutes to avoid constitutional problems. *See* NCTA Br. 26-27; Gov't Br. 40-41. But that canon of statutory construction has no application here. Petitioners' so-called "saving" construction of section 533(b) does not construe the substantive provisions of the statute so as to eliminate an infringement on First Amendment activity. This case is not at all like *Catholic Bishop*, where the

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a monopoly on local telephone company service" and "*does* generally bar a telephone company from selecting (or 'exerting editorial control over') and providing the video programming carried over its wires in its local service area." Pet. Supp. App. 3a (emphasis in original).

[17] "[W]e construe Section [533](b)(4), the waiver provision, as authorizing us to permit telephone companies to act as programmers on video dialtone systems pursuant to certain conditions." Pet. Supp. App. 9a.

Court construed the National Labor Relations Act not to apply to teachers in parochial schools and thereby avoided serious freedom of religion concerns, 440 U.S. at 507; nor is it like *Edward J. DeBartolo Corp.* v. *Florida Gulf Coast Building & Construction Trades Council*, where the Court construed the same statute not to apply to peaceful handbilling and thereby avoided serious freedom of speech concerns, 485 U.S. 568, 575-88 (1988). Here, the FCC has not construed the substantive provisions of the statute at all: both before and after the FCC's new construction, the statute prohibits a large amount of protected speech without any adequate reason for doing so. Such a statute is not "saved" by the responsible agency's promise not to enforce it in some cases under conditions the agency unilaterally adopts.

The Government argues that the possibility that a telephone company can obtain a waiver to provide in-region video programming "removes any objections to the tailoring of the congressional regime" by offering a "less burdensome alternative" to the total ban. Gov't Br. 42. This Court rejected an indistinguishable argument in *Secretary of State of Maryland* v. *J.H. Munson Co.*, 467 U.S. 947 (1984). In holding that a percentage restriction on charitable solicitation was not narrowly tailored to meet any substantial governmental interests and thus was unconstitutional on its face, *id.* at 965-66, the Court noted that the statute's waiver provision was unavailing: "The possibility of a waiver may decrease the number of impermissible applications of the statute, but it does nothing to remedy the statute's fundamental defect." [18]

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[18] In the *Third Report and Order*, the FCC attempts to distinguish *Munson* by arguing that a liberal application of the section 533(b) waiver "furthers rather than hinders First Amendment interests" by creating additional speaking opportunities. Pet. Supp. App. 18a-19a. The Court rejected this argument in *Munson*, noting that where the statute itself "is so poorly suited to accomplishing the State's goal, and where there are alternative means to serve the same purpose, there is little justification for straining to salvage

Id. at 968; *see also Lovell* v. *City of Griffin*, 303 U.S. 444 (1938) (blanket ban on speech ruled facially unconstitutional notwithstanding license procedure that might have permitted petitioner to engage in the speech activity).

B. The FCC's Promise of Administrative Charity Does Not Vindicate Telephone Companies' First Amendment Rights

Under the regime contemplated by the *Third Report and Order*, the video programming ban would remain in place, and telephone companies would be dependent on the FCC for the right to provide video programming to in-region customers. This is not a satisfactory cure for the First Amendment problems of the statute, for at least two reasons.

First, the FCC's new regime would remain subject to change in the FCC's discretion. The FCC based its new interpretation of the statute's waiver provision on the "changed circumstances" that characterize the 1995 cable market as compared to the 1970 or 1984 cable markets. These changed circumstances, the agency said, qualify as the type of "good cause" contemplated by section 533(b)(4). Pet. Supp. App. 9a-13a; *see* Gov't Br. 40. But nothing prevents the agency from changing its mind again, with or without another change of circumstances, real or perceived. Indeed, the FCC is not bound even by its pronouncement that "the rules [it] will promulgate in the immediate future to authorize telephone companies to provide video programming in their service areas will constitute 'particular circumstances . . . taking into account the policy' of Section [533](b)." Pet. Supp. App. 13a. The agency is free at any point to require an additional showing by telephone companies that "particular circumstances" justify individual waivers, or to change

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the statute by invoking the possibility of official dispensation to engage in protected activity." 467 U.S. at 964 n.12.

the rules that constitute such circumstances. Because the underlying video programming ban remains in effect, the agency is free to modify its policy as it deems necessary, leaving telephone companies with greater or lesser restrictions on their opportunities for speech.

Second, the FCC has not fully set out even the conditions under which it *now* proposes to dispense its administrative charity. In the *Third Report and Order*, the FCC claims the authority "to permit telephone companies to act as programmers on video dialtone systems *pursuant to certain conditions*." Pet. Supp. App. 9a (emphasis added). The agency admits, however, that it has not yet determined what those "conditions" are, leaving open such major issues as "whether telephone companies may provide video programming over video dialtone networks rather than as traditional cable operators" and whether they will be regulated under Title II or Title VI of the Communications Act. *Id.* at 3a; *see id.* at 14a n.36. The FCC promises to "address the terms and conditions under which telephone companies should be permitted to provide video programming directly to subscribers in their local service areas in a subsequent order," *id.* at 6a n.11, but it provides no timeframe for doing so.[19] Any decisions

[19] The FCC generally suggests that telephone company in-region video programming ventures would be subject to video dialtone platform rules and could not utilize an anchor programmer. Pet. Supp. App. 13a. Yet even those issues are explicitly left open in the Commission's *Fourth Notice of Proposed Rulemaking*, on which the Commission has yet to act. *See Telephone Company—Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Fourth Further Notice of Proposed Rulemaking*, 10 FCC Rcd 4617 (1995) (Pet. App. 113a). Petitioner NCTA suggests a host of additional "conduct-specific" conditions that the agency might apply to telephone companies seeking waivers, including operating stand-alone cable systems, complying with Title VI of the Communications Act, and requirements relating to corporate structure, accounting methods, audits, and nondiscriminatory practices. NCTA Br. 32. To date, the agency has not adopted or rejected these proposals or any other specific rules.

the FCC does reach in the future will likely face lengthy administrative and judicial challenges.[20] This remarkable uncertainty regarding the terms of possible administrative waivers of section 533(b) underscores the immediate practical difference between a judicial decision striking down the statute and ongoing administrative proceedings that dole out speaking opportunities on a schedule the agency has yet to determine.

C. The FCC's Enlargement of Its Own Administrative Discretion Only Exacerbates the Problem

The FCC's broad waiver policy also creates its own, additional First Amendment concerns by creating a "licensing" process in which telephone companies may exercise their First Amendment rights only if the FCC, in its discretion, approves. The "good cause" waiver policy is not a blanket authorization for all telephone companies to provide in-region video programming. It merely *authorizes* the FCC to dispense speaking opportunities to telephone companies that file specific waiver requests. *See* Pet. Supp. App. 15a; NCTA Br. 31-32. The grant of such a waiver by the FCC will rest "upon compliance with regulations to be published that will be designed to prevent anti-competitive conduct." Gov't Br. 41. The waiver policy therefore vests unimpeded discretion in the agency to determine whether telephone companies seeking to offer in-region video programming should be permitted to do so.

It is fundamental in First Amendment jurisprudence that a statute requiring a "license" for the dissemination of ideas and placing discretion in the hands of government officials to grant or deny the license "creates a threat of censorship that by its very existence chills free speech." *Munson*, 467 U.S. at 964 n.12. As this Court observed in *City of Lakewood* v. *Plain Dealer Publishing Co.*, the

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[20] *See, e.g., GTE California Inc.* v. *FCC*, No. 96-70618 (9th Cir. June 28, 1996) (petition for review of *Third Report and Order*).

Government "may not condition . . . speech on obtaining a license or permit from a government official in that official's boundless discretion." 486 U.S. 750, 764 (1988) (emphasis omitted). "[I]n the absence of narrowly drawn, reasonable and definite standards for the officials to follow," license requirements create the possibility for abuse and censorship of First Amendment rights. *Niemotko* v. *Maryland*, 340 U.S. 268, 271-72 (1951); *see Cox* v. *Louisiana*, 379 U.S. 536, 555-557 (1965); *Kunz* v. *New York*, 340 U.S. 290, 294 (1951); *Saia* v. *New York*, 334 U.S. 558 (1948); *Cantwell* v. *Connecticut*, 310 U.S. 296, 305 (1940); *Schneider* v. *State (Town of Irvington)*, 308 U.S. 147, 163-64 (1939).

The Government suggests that the FCC's proposed "good cause" waiver "does not raise any of the constitutional concerns that have been associated with waiver provisions in other First Amendment contexts," Gov't Br. 41, because the FCC will " 'routinely' grant waivers of the cross-ownership bar . . . to [telephone companies] that agree to abide by [the agency's] safeguards in their video dialtone systems," *id.* at 39-40. Those "safeguards," however, have not been specified and will be decided by the FCC based on its judgment concerning the circumstances under which telephone companies should be permitted to exercise their First Amendment rights. The Court is thus asked to hold that section 533(b) is constitutional based on nothing more than a promise by the FCC that the agency will restrict itself from exercising its discretion in an unconstitutional manner.

Such circular arguments and unsubstantiated promises cannot sidestep the statute's plain, unconstitutional language. In *City of Lakewood*, this Court rejected the invitation to presume that "the mayor will deny a permit application only for reasons related to the health, safety, or welfare of Lakewood citizens, and that additional terms and conditions will be imposed only for similar reasons," reasoning that this "is the very presumption that the doc-

trine forbidding unbridled discretion disallows." 486 U.S. at 770. As the Court ruled, "[t]o allow these illusory 'constraints' to constitute the standards necessary to bound a licensor's discretion renders the guarantee against censorship little more than a high-sounding ideal." *Id.* at 769-70.

D. There Is No Reason Now To Address the New Regime the FCC Has Proposed To Replace the Blanket Ban Enacted by Congress

In the court of appeals below, in the Ninth Circuit, and in district courts across the country, the Government argued that the courts should not substitute their own views, or the views of the FCC, for the policy views that the Government's litigators attributed to Congress. In the first part of its brief in this Court, the Government continues to argue that "the courts owe substantial deference" to Congress's supposed "predictive judgment" that a blanket ban on telephone company provision of cable television service is necessary. Gov't Br. 32 n.21.

The Government's final argument, by contrast, takes Congress out of the picture. The Government argues that since the FCC has concluded that circumstances have changed substantially and has substituted a dramatically different regulatory regime based on video dialtone platforms and waivers, the Court should ignore the constitutional defects in what Congress has done and sanction the agency's unilateral rewrite. Respondents and supporting *amici* have shown that the statute as Congress wrote it is unconstitutional and cannot be saved in this manner. There is, however, a further and final point: the FCC rewrite is premised on the very decisions the Government now asks this Court to reverse, is still incomplete, and has not been subjected to any review in the lower courts. There is therefore no reason for the Court to address the new regime now. The Court should affirm the decision of the Fourth Circuit and leave it to

Congress and the FCC to decide, subject to appropriate judicial review, what to do next.

CONCLUSION

For the foregoing reasons, the judgment below should be affirmed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, *et al.*,
Petitioners,

v.

C & P TELEPHONE CO. OF VIRGINIA, *et al.*
Respondents.

On Writs of Certiorari to the
United States Court of Appeals
for the Fourth Circuit

BRIEF OF METS FANS UNITED/VIRGINIA CONSUMERS FOR CABLE CHOICE, ALEXANDRIA FEDERATION OF CIVIC ASSOCIATIONS, TELEVISION VIEWERS OF AMERICA, VIRGINIA ASSOCIATION OF THE DEAF, NORTHERN VIRGINIA RESOURCE CENTER FOR DEAF AND HARD OF HEARING PERSONS, UNITED HOMEOWNERS ASSOCIATION, AND VIRGINIA PUBLIC INTEREST COALITION, AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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INTEREST OF *AMICI CURIAE*

With the consent of the parties,[1] *amici curiae* METS Fans United/Virginia Consumers for Cable Choice, *et al.*, hereby submit this brief in support of respondents. *Amici* are a coalition of consumer groups which support elimination of § 533(b) to promote diversity in media voices, competition in the cable television market, and access to video programming for people with disabilities. *Amici* represent a wide range of organizations and consumer interests:

METS Fans United/Virginia Consumers for Cable Choice is an association of cable television consumers who believe that lifting § 533(b) and permitting Bell Atlantic to provide video programming in the Alexandria market will open up competition with the incumbent cable operator and provide viewers with access to alternative programming sources.

The Alexandria Federation of Civic Associations, Inc. is a not-for-profit organization whose membership includes 75 civic, condominium and apartment associations in the City of Alexandria. The Federation believes that eliminating § 533(b) will promote cable competition in the City of Alexandria and increase the public's access to alternative programming sources and government and public access channels.

Television Viewers of America is a grassroots consumer organization actively pursuing legal and regulatory initiatives to bring nationwide competition to multi-channel video programming and lower rates and better service to consumers.

Virginia Association of the Deaf, Inc., is a non-profit association whose goals are to serve the deaf and promote their unique needs in legislation, education, communication, health care, research, rehabilitation and individual family counseling. The Association believes that a favorable decision in this case will provide greater access to telecommunications and programming services that meet the needs of the deaf.

Northern Virginia Resource Center for Deaf and Hard of Hearing Persons is a not-for-profit social service agency serving

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[1] Letters reflecting written consent of the parties to the submission of this brief have been filed with the Clerk of the Court.

deaf persons and those with hearing difficulties, their families, friends and other professionals. The Center believes that the increased competition offered by local telephone companies can increase access to video programming for deaf and hard of hearing persons.

United Homeowners Association is a non-profit association whose goal is to inform and represent homeowners across the country. UHA believes that the competition from telephone companies in the provision of cable television programming services will increase consumer choices and lower cable rates.

Virginia Public Interest Coalition is an informal group of individuals and organizations concerned about the public interest and telecommunications in Virginia. The coalition works to ensure that a consumer voice representing the interest of educators, the elderly, people with disabilities, workers and others is heard during the public debate on telecommunications issues. The Coalition believes that lifting § 533(b) will result in increased competition in the provision of cable television services, lower prices and greater access to programming services.

INTRODUCTION AND SUMMARY OF ARGUMENT

This Court has frequently stressed that the First Amendment protects not simply the right of a speaker to *speak*, but also the right of the audience and the public to *hear*. Yet § 533(b), by barring willing speakers from communicating with willing listeners, runs roughshod over this fundamental principle of free speech.

The First Amendment issue presented here is not some academic nicety. It is the very real question of whether millions of potential viewers will be prevented from fully participating in the most important medium of communication today. During both the Bush and Clinton Administrations, every federal agency with responsibility for fashioning telecommunications policy has recommended that § 533(b) be eliminated. In particular, the Federal Communications Commission (FCC) has predicted that allowing competition by telephone companies in video

programming would expand subscribership by 11.2 million households nationwide and produce annual consumer benefits of some $5.36 billion.

In determining whether § 533(b) could survive intermediate scrutiny, the Court should pay particular attention to the historical record compiled by the federal agencies involved in enforcing this statute, which demonstrates its patent unconstitutionality.

ARGUMENT

I. SECTION 533(b) VIOLATES FREE SPEECH RIGHTS BY BARRING WILLING SPEAKERS FROM COMMUNICATING WITH WILLING LISTENERS

Audiences have a right under the First Amendment to receive programming by local telephone companies, and this right is independent of the right of telephone companies to speak. This Court has frequently recognized that First Amendment rights belong to recipients — or potential recipients — of speech as well as to the speakers themselves. In *Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748 (1976), for example, this Court determined that the First Amendment rights of the public to receive information provided an independent legal basis for consumers to challenge government regulation of speech. This Court observed that it "is clear from the decided cases" that the First Amendment protects the "right to 'receive information and ideas.'" *Id.* at 756-57 (quoting *Kleindienst v. Mandel*, 408 U.S. 753, 762-63 (1972)). The Court has since reiterated that "the extension of First Amendment protection" may be justified by the value to consumers and the public "of the information that such speech provides." *Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626, 651 (1985).[2]

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[2] *See also Lamont v. Postmaster General*, 381 U.S. 301 (1965) (upholding First Amendment rights of citizens to receive political publications from abroad, from foreign speakers whose ability to invoke the First Amendment was open to question); *Thomas v. Collins*, 323 U.S. 516, 534 (1945) (sustaining worker's

Even where a would-be speaker, rather than a listener or viewer, is the actual party challenging a law under the First Amendment, the speaker is entitled to invoke the *public's* right to a diversity of information sources. "The Constitution often protects interests broader than those of the party seeking their vindication. The First Amendment, in particular, serves significant societal interests." *First National Bank of Boston v. Bellotti*, 435 U.S. 765, 776 (1978). In *First National Bank*, this Court permitted a business corporation to challenge a prohibition on speech not because of the First Amendment's role "in fostering individual self-expression," but rather because of "its role in affording the public access to discussion, debate, and the dissemination of information and ideas." *Id.* at 783. This Court added that "the First Amendment goes beyond protection of the press and the self-expression of individuals to prohibit the government from limiting the stock of information from which members of the public may draw." *Id.*[3]

"At the heart of the First Amendment lies the principle that each person should decide for him or herself the ideas and beliefs deserving of expression, consideration, and adherence. Our political system and cultural life rest upon this ideal." *Turner Broadcasting Sys., Inc. v. FCC*, 114 S. Ct. 2445, 2458 (1994);

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right to meet, discuss, and be informed of impending election for collective bargaining agent); *Martin v. Struthers*, 319 U.S. 141, 143 (1943) ("this freedom embraces the right to distribute literature . . . and necessarily protects the right to receive it"); *Stanley v. Georgia*, 394 U.S. 557, 564 (1969) ("This right to receive information and ideas, regardless of their social worth . . . is fundamental to our free society.").

[3] In this case, the diversity principle does not support the constitutionality of § 533(b). In fact, that principle undermines the statute. In the Court of Appeals, *amici* addressed the question of whether the principle of diversity in *FCC v. National Citizens Committee for Broadcasting*, 436 U.S. 775 (1978) ("*NCCB*"), supported § 533(b). *See* Br. of METS Fans, *et al.* in Ct. App. 17-22. *Amici* noted that the restriction in *NCCB* prevented broadcasters from purchasing a newspaper and thus eliminating an additional voice. Section 533(b), by contrast, prohibits a telephone company from adding its voice by becoming a cable provider. This is not a cross-ownership case.

see also Edenfield v. Fane, 113 S. Ct. 1792, 1798 (1993) ("the general rule is that the speaker and the audience, not the government, assess the value of the information presented").

II. FEDERAL TELECOMMUNICATIONS AGENCIES HAVE DETERMINED THAT SECTION 533(b) IS ANTICOMPETITIVE AND HARMS CONSUMERS

The First Amendment right to receive information is particularly salient here, for every federal telecommunications agency has urged elimination of § 533(b) on the ground that it is anticompetitive and harms consumer interests.

The court below evaluated the constitutionality of § 533(b) under "the intermediate level of scrutiny applicable to content-neutral restrictions that impose an incidental burden on speech." *Turner Broadcasting*, 114 S. Ct. at 2469. This standard of review requires the Government to establish that the measure challenged on free speech grounds: (1) is narrowly tailored to achieve substantial government interests; and (2) leaves open ample alternative channels for communication. *See, e.g., Ward v. Rock Against Racism, Inc.*, 491 U.S. 781, 789, 799 (1989). Both of these inquiries rest in part on an assessment of the purported justifications for the challenged measure, and thus can be advanced by an examination of legitimate, reliable information that bears upon these independent prongs of the "intermediate scrutiny" standard.

In providing guidance to the courts about the legitimate sources that they should consult and consider in undertaking these evaluations, this Court has begun with an important cautionary reminder: any court exercising the power of judicial review of the constitutionality of a statute has an "obligation to exercise independent judgment when First Amendment rights are implicated." *Turner Broadcasting*, 114 S. Ct. at 2471. The exercise of independent judgment is critical in determining whether the Government has carried its burden of demonstrating "that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way." *Id.* at 2470.

With this fundamental point established, however, the next step is to decide what sources provide legitimate material that will aid in exploring the two basic prongs of intermediate scrutiny. Here, this Court has stressed the importance of identifying sound information for the purpose of conducting these twin inquiries, observing that the Government cannot carry its burden under the First Amendment by offering "mere speculation and conjecture." *Rubin v. Coors Brewing Co.*, 115 S. Ct. 1585, 1592 (1995). "[R]ather, a governmental body seeking to sustain a restriction" against a First Amendment challenge "must demonstrate that the harms it recites are real and that its restriction will in fact alleviate them to a material degree." *Edenfield*, 113 S. Ct. at 1800. Casual submissions based on "anecdotal evidence and educated guesses" are insufficient bases on which to restrict free speech rights, and "litigating positions," such as those belatedly put forward by the Government in this case, cannot be used as reliable "proof that the Government's regulation is necessary." *Rubin*, 115 S. Ct. at 1593.

When the Government agencies charged with enforcing a given prohibition on speech have all concluded it is not essential to further any substantial government interest — and, indeed, that it positively disserves any such interests — it is difficult to imagine that the law could survive any form of First Amendment scrutiny. This Court has often attached weight to factual findings by responsible policymakers that undercut the validity of a restriction on speech. *E.g.*, *Sable Communications of California, Inc. v. FCC*, 492 U.S. 115, 130 (1989); *Miami Herald Publishing Co. v. Tornillo*, 418 U.S. 241, 247 n.7 (1974). The situation here is much starker than anything this Court has encountered before: every agency participating in the formation of telecommunications policy that has examined § 533(b) has concluded that it retards competition and injures consumers. By their own statements, the relevant Government agencies have already established that they cannot meet their burden under the First Amendment of justifying § 533(b). To take those agencies at their word entails no "second-guess[ing] [of] the Government's judgment." *Board of Trustees of State University of New York v. Fox*, 492 U.S. 469, 478 (1989).

To be sure, purported administrative "findings" would be suspect if they were unaccompanied by objective indicia of reliability, such as internal consistency and factual completeness. Similarly, they would be entitled to little or no weight if they were made for the purposes of litigation or reflected inconsistencies in approach or a self-interested concern in extending and protecting the scope of the agency's own authority in a particular sphere. *See, e.g., Watt v. Alaska*, 451 U.S. 259, 273 (1981) (agency position inconsistent over time is "entitled to considerably less deference" than a consistently held agency view); *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 386 (1988) (Brennan, J., dissenting) (deference to agency position must take into account consideration of the agency's "institutional interests in expanding its own power").

But those caveats are not applicable here. Federal telecommunications policymakers have *unanimously* condemned § 533(b) as anticompetitive and anti-consumer. They have done so on the basis of a comprehensive historical record that reflects the modern development and growth of the American telecommunications industry. This striking conclusion about the counterproductive consequences of § 533(b) has been consistent across the different federal agencies involved in this area even though, from the perspective of the agencies' narrow self-interest in expanding their own enforcement authority, invalidation of this measure likely would restrict that authority. This broad consensus that § 533(b) is entirely disconnected to any significant government interest is thus entitled to special weight in this Court's constitutional examination of whether this statute can satisfy the two distinct prongs of intermediate scrutiny. And the following examination clearly shows that § 533(b) is not "narrowly tailored" to accomplish *any* legitimate government interest.

1. For years, the FCC has explained that its position on the inefficacy of § 533(b) is based on its considered judgment that "competition provided by telephone companies can be expected to provide . . . lower costs and greater choices for consumers and greater responsiveness to consumer demand by service providers." *Telephone Company-Cable Television Cross-Ownership Rules*, 3

FCC Rcd 5849, 5857 (1988) (quoted at J.A. 341). The evidence compiled by the Commission almost a decade ago demonstrated "that the prohibition against telephone companies providing cable television service within their telephone service areas no longer serves the public interest. . . . The ban directly deprives consumers of video programming services telephone companies could provide [and] prevents market incentives and achievement of efficiencies that could bring additional services to the public." *Id.* at 5866 (quoted in J.A. 341).

As the evidence has accumulated, the FCC has become increasingly emphatic in stating its position that § 533(b) does not serve the public interest and does not advance any legitimate government interest. In 1992, it issued a further report and order, in which it determined that removing § 533(b) would "increas[e] competition in the video marketplace, spur[] the investment necessary to deploy an advanced infrastructure, and increas[e] the diversity of services made available to the public." *Telephone Company-Cable Television Cross-Ownership Rules*, 7 FCC Rcd 5781, 5847 (1992) (quoted at J.A. 337). After reviewing the evidence that had been amassed in the formal administrative record, the Commission recommended that Congress abolish the prohibition on telephone companies providing video programming "directly to subscribers in their telephone service areas." *Id.* As the Commission explained: "permitting local telephone companies to directly provide video programming will further increase diversity, as they will add another programming voice to those which now exist. . . . Most importantly, we find that the public will benefit greatly from the resulting increased competition in the video marketplace." *Id.* at 5849-50 (quoted at J.A. 338).

In May 1995, in its most recent report and order on the subject, the FCC formally reiterated its position that "authorizing telephone companies to provide video programming" would "promote competition in the multi-channel video programming market." Govt. Supp. Br. App. 5a. "Since 1970, . . . the cable industry has grown from a fledgling service to a more mature industry that now serves a majority of households and 'has replaced over-the-air broadcast teleision the primary provider of

video programming.'" *Id.* at 11a. "These developments have . . . mitigated to a fair degree the competitive concerns that led the Commission and Congress to adopt the cross-ownership ban." *Id.* at 12a.

The Commission has even gone so far as to quantify the tremendous benefits that would be attained by lifting the statutory ban on video programming by telephone companies. According to the FCC's own statistics, eliminating § 533(b) "would result in significant price savings for consumers and stimulate provision of a range of new information services," with rates falling about 20 percent and subscribership increasing by 11.2 million households nationwide. Report of the Federal Communications Commission Regarding the President's Regulatory Reform Program 16 (Apr. 28, 1991) (quoted at J.A. 339-40). The Commission has predicted that competition would produce annual consumer gains of $5.36 billion, not counting "the significant gains in innovative uses of broadband communications in non-entertainment markets, such as health care, education, and telecommuting, all of which are very likely to follow from enhanced capacity and competitiveness in the supply of cable television services." *Id.* (quoted at J.A. 340).

The current Chairman of the FCC, Reed E. Hundt, summarized the Commission's official position on the counterproductive nature of § 533(b) in congressional testimony delivered on January 27, 1994:

> Direct, facilities-based competition between cable and telephone companies will produce *substantial benefits for the American public*. Competition in this market will spur the deployment of advanced technologies that are capable of delivering the full range of services that customers demand. These services include not only entertainment services, but also the growing number of *educational, health, and social services that are accessible over broadband technologies*.
>
> In addition, competition in this market can be expected to produce the same positive results for consumers that we

> have in other markets for telecommunications services that have undergone the transformation from monopoly to competition: *technological and service innovation, lower prices, and responsiveness to consumer tastes*. Telephone company entry also will *expand the electronic marketplace of ideas* by creating new outlets for video service providers.
>
> * * *
>
> Elimination of the existing cross-ownership restriction should stimulate new telephone company investment in facilities that are capable of delivering video and advanced telecommunications services. *Consumers should be the beneficiaries of the expanded choices that facilities-based competition in this market will foster*.

J.A. 376-77 (emphases added). He thus maintains the same position as the former Chairman of the FCC, James H. Quello, who also agreed that the removal of § 533(b) would "bring consumers lower rates, more responsive customer service, and greater choice of video programming sources." Letter from James H. Quello, FCC Chairman to Hon. Edward J. Markey (Mar. 1, 1993) (quoted at J.A. 338-39).

In short, the FCC has built an overwhelming administrative record that § 533(b)'s direct ban on video programming by telephone companies within their service areas is entirely counterproductive and thus does not serve any government interest.[4]

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[4] Experience tends to support the FCC's conclusions. For example, many cable operators raised rates, re-tiered channels, or otherwise altered their service just as congressionally mandated rate regulation took effect, in the form of the Cable Television Consumer Protection and Competition Act of 1992, 106 Stat. 1460. *See Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, Second Order on Recon., 9 FCC Rcd 4119, 4166 (1994). Subsequently, the FCC found that about 30 percent of the cable systems had raised regulated rates, even under the 1992 Cable Act. Cable Services Bureau, *FCC Cable Regulation Impact Survey,*

2. The Department of Justice has similarly concluded that removing § 533(b) "will allow another competitor to enter the video programming market, . . . increase the [telephone companies'] willingness to take the financial risk of developing broadband integrated networks, [and] make them more effective competitors."[5] It has also determined that telephone companies' "provision of video programming will have procompetitive benefits that outweigh any anticompetitive risks involved," and thus they "should be allowed to own and directly provide video programming."[6]

The Department thus has consistently urged Congress to do away with § 533(b), which is counterproductive of its actual objectives. In 1991, the Assistant Attorney General for the Antitrust Division, together with the Secretary of Commerce, stated their position in these words: "We think that Congress can best serve television viewers by removing barriers to entry by new firms into the video services marketplace. The Administration therefore supports removal of current legislative prohibitions against telephone company provision of video programming." Letter from James F. Rill, Assistant Attorney General, Antitrust Division and Robert A. Mosbacher, Secretary of Commerce to Hon. John C. Danforth (Mar. 13, 1991) (quoted at J.A. 343). In congressional testimony presented on January 27, 1994, Anne K. Bingaman, Assistant Attorney General for the Antitrust Division in the new Administration, reaffirmed the Department's views:

Changes in Cable Television Rates Between Apr. 5, 1993-Sept. 1, 1993, at 3 (Feb. 22, 1994). A notable exception was the City of Alexandria, Virginia, in which the incumbent cable operator — facing the prospect of head-to-head competition from Bell Atlantic — actually decreased its rates by more than 10 percent. *See* Hong, *Cable Rates Drop in Alexandria*, Washington Post, Sept. 9, 1993, at V-1.

[5] Reply Comments of the United States Department of Justice before the Federal Communications Commission, *Telephone Company-Cable Television Cross-Ownership Rules*, CC Dkt 87-266 at 44-45 (Mar. 13, 1992) (quoted at J.A. 342).

[6] *Id.* (quoted at J.A. 342).

"The Administration . . . strongly endorses the provisions of H.R. 3636 that would permit existing cable and telephone companies to offer both video and telephonic services in the same geographic areas. . . . It is crucial that public policy promote competition between methods for delivering telecommunication services." J.A. 381.

3. These conclusions have also been independently confirmed by the National Telecommunications and Information Administration (NTIA), a unit of the Department of Commerce that is responsible for telecommunications policy. The NTIA has determined that:

> In general, government restrictions that have the effect of limiting the uses to which new technology can be put tend to be inefficient and anticompetitive, and retard investment in that new technology. In particular, we believe that the current cable/telco crossownership rules are having such an effect wth respect to investment in broadband public network technology.

NTIA, TELECOMMUNICATIONS IN THE AGE OF INFORMATION 235 (1991) (quoted at J.A. 344). The NTIA has also stated that "the likely benefits of LEC [local exchange carrier] entry into the video programming business outweigh the potential costs of LEC provision of video programming," and that "[t]he opportunity to provide programming should increase LECs' incentives to construct integrated broadband network facilities to carry that programming to the home. This, in turn, could lead to introduction of a wide range of innovative voice, data, and video services for subscribers." *Id.*

In 1992, the NTIA reiterated its documented concerns "about the continuing wisdom of this restriction" on video programming contained in § 533(b), and noted that "we have repeatedly advocated its elimination."[7] As the NTIA explained again in more

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[7] Reply of the National Telecommunications and Information Administration, *In Re Teleport Communications — New York*, File No. 13135-CF-TC(3)-92, at 3 (May 27, 1992) (quoted at J.A. 346).

detail: "Allowing telephone companies to provide video programming in their local service areas would significantly increase competition in the video services market, which would, in turn, yield lower prices to viewers, better service quality, and better programming diversity." *Id.* In January 1994, this view was reaffirmed in congressional testimony by Larry Irving, Assistant Secretary of the Department of Commerce for Communications and Information. J.A. 382, 383.

4. Finally, in January 1994, the Clinton Administration released its "White Paper on Communications Act Reforms," which outlined the Administration's proposal to remove § 533(b) on the ground that the statute is merely an undesirable obstruction to the important goal of securing and promoting competition in the telecommunications industry. As the White Paper states the matter: "Although the existing cable-telephone company cross-ownership restriction of the 1984 Cable Act may have been appropriate when enacted, today it is an unnecessary and artificial barrier to competition in the delivery of video programming to American consumers and to investment in advanced local infrastructure." J.A. 370.

Taken together, these statements represent an impressive and extremely thorough historical record, which establishes that § 533(b) does not advance any legitimate government interest. Instead, the administrative record compiled by these federal officials establishes that § 533(b) runs counter to the most important objectives of established governmental policy toward this industry, even as it imposes direct and substantial restrictions on free speech. This conclusion, moreover, has been reached by *all* of the officials who are charged with exercising responsibility across the entire spectrum of federal authority to set national telecommunications policy. The sound expertise reflected in the historical record compiled by these officials, which plainly shows that the very statute they are authorized to administer and enforce is *counterproductive* and affirmatively hinders the government's asserted interest, warrants very close examination by this Court in assessing the validity of § 533(b). On the basis of this record, it

is simply impossible to conclude that § 533(b) is "narrowly tailored" to serve that interest.

III. THE ANTICOMPETITIVE EFFECTS OF SECTION 533(b) ARE FELT BY MILLIONS OF POTENTIAL VIEWERS

A law that shuts out millions of consumers from the Nation's most important medium of expression cannot be deemed to leave adequate alternative channels of communication open to the public. Section 533(b) relegates a telephone company to three "alternative" means of expression, which are completely unsatisfactory from the standpoint of the consumer interests of the public: (1) video programming *outside* its telephone service area; (2) *non*-video programming forms of speech; and (3) the creation of video programs distributed in-region by local broadcasters, cable operators, or video stores, *outside the telephone company's editorial control*.

Whether or not these alternatives are "ample" as to the telephone company speaker (and we believe that they are not), they plainly are inadequate from the perspective of the *public*. The first option, programming outside the region, is no alternative at all for consumers who are located within the telephone company's service area. Out-of-region programming involves an entirely different audience. Members of the public are not fungible, and the protected rights of one audience cannot be denied on the ground that the speaker can address a different audience instead. *See Schneider v. State*, 308 U.S. 147, 163 (1939).

Nor do the in-region "alternatives" offer consumers any meaningful substitute. To be sure, § 533(b) allows telephone companies to publish newspapers or distribute handbills, but in the modern age of telecommunications, video programming has become the public's primary source of news and information. Millions more people have televisions than subscribe to newspapers, and the average television household watches television seven hours per day, and the average resident spends almost ten times as many hours watching television as reading the

newspaper. *See* J.A. 196-97 (Stipulated Facts 10-14). Moreover, the "power to communicate ideas through sound and visual images . . . is significantly different from traditional avenues of communication because of the immediacy of the medium." *Telecommunications Research & Action Center v. FCC*, 801 F.2d 501, 508 (D.C. Cir. 1986) (quoting FCC Report and Order), *cert. denied*, 482 U.S. 919 (1987).

Similarly, the in-region distribution of telephone company speech by cable operators and broadcasters, at the discretion of these existing owners, is certainly no adequate substitute from the perspective of consumers. The fact is that there is already far more video programming than these incumbent cable operators can possibly carry. Cable operators currently have an average capacity of about 40 channels. J.A. 198 (Stipulated Fact 20). Yet there are already available many more sources of programming: local broadcast stations, more than 75 basic cable networks, 42 regional networks, 7 pay networks, 7 pay-per-view networks, and other text and audio services. J.A. 144-45 (Affidavit of William E. Lee ¶¶ 6(a), 6(b)). Accordingly, the Government has stipulated in this case that "[c]urrently, the supply of available video programming exceeds the available channel capacity of almost all cable systems." J.A. 198 (Stipulated Fact 19).

Furthermore, if independent video programmers are to reach their audiences and expand the diversity of information available to the public, they need the very editorial support and coordination that § 533(b) forbids telephone companies from providing. Thus, it was undisputed in the courts below that, as a prominent independent video producer explained, "[i]ndependent video producers and media artists are producing much more video programming than is currently being distributed on existing systems. As long as show producers and distributors stand as 'gatekeepers' for the viewing audience, voices that do not conform to the video carriers' needs will not be heard." J.A. 324 (Affidavit of Robin Smith ¶ 6). Telephone companies' "ability to package, market, and distribute video programming for access on demand presents new opportunities for independent producers and media artists to reach a much larger audience." *Id.* (at ¶ 7).

Lifting § 533(b) would thus permit a wide range of new voices to be heard:

> A new genre of programming will emerge, utilizing the new interactive technologies in ways that are more responsive to the needs of individuals. . . . With more distribution outlets, small independent and non-profit producers will gain a precious commodity — a platform for *diverse voices and visions that can be shared with the broadest possible audience*.

Id. (at ¶ 8) (emphasis added).

This effect of removing § 533(b) is also borne out by the historical record compiled by the federal agencies, as described in more detail above. The NTIA, for example, has urged that "the availability of broadband facilities will likely spawn new applications — video and non-video alike — as entrepreneurs and carriers devise new service offerings that will benefit the American public." NTIA, TELECOMMUNICATIONS IN THE AGE OF INFORMATION 234 (1991) (quoted at J.A. 344-45). "This, in turn, could lead to introductions of a wide range of innovative voice, data, and video services for subscribers." *Id.* at 235 (quoted at J.A. 344). The White Paper similarly notes that the removal of § 533(b) "will allow telephone companies and cable operators to compete in providing a full range of video, voice, and data services to the public. Such competition can promote investment that expands consumer choices and services." J.A. 370.

The key element in achieving these benefits for the public is the ability of the telephone companies to exercise editorial control as they would undertake to compete in providing such programming, which is nonetheless banned by § 533(b):

> *[M]ere provision of transmission facilities is not sufficient.* [Telephone companies] would still be forbidden to perform the kind of packaging, marketing and publicity functions that are crucial to the success of smaller producers. . . . [H]aving such services available to all producers can make the difference between a film that passes unnoticed and a professional production that serves to challenge people by adding to the *diversity of opinion in the public forum.*

J.A. 326 (at ¶ 12) (emphases added).

Providing consumers and independent video producers with "leased access" cable channels in no way compensates for their lost opportunity to access the extensive programming package that telephone companies could offer in the absence of § 533(b). The FCC's "leased access" requirements make available only one or two channels (at most) of a cable operator's capacity. J.A. 284-85 (Affidavit of Jean Pool ¶ 4). Accordingly, Congress has concluded that "leased access has not been an effective mechanism for securing access for programmers to the cable infrastructure or cable subscribers." H.R. Rep. No. 628, 102d Cong., 2nd Sess. 39 (1992).[8] Even if one or two cable channels were made available to the telephone company or to another video programmer, the bottom line would be that viewers would end up with one (limited) voice simply replacing another, whereas what consumers want — and what they are constitutionally entitled to receive — are additional programming voices.

For all of these reasons, § 533(b) leaves consumers with no adequate alternative means of communication. It is vital that telephone companies be permitted to provide video programming directly to their in-region subscribers. By directly prohibiting this important means of providing "lower prices to viewers, better

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[8] *See also* Donna N. Lampert, *Cable Television: Does Leased Access Mean Least Access?*, 44 FED. COMM. L.J. 245, 248 (Mar. 1992) ("the access provisions of the Cable Act have wholly failed to serve their intended purpose of reducing the bottleneck control of cable operators").

service quality, and better programming diversity," § 533(b) deprives "all users, residential and business alike," of these important benefits. NTIA Reply at 3 (quoted in J.A. 346). It therefore cannot pass muster under the "intermediate scrutiny" standard of constitutional review.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, *et al.*,
Petitioners,

v.

CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA, *et al.*,
Respondents.

NATIONAL CABLE TELEVISION ASSOCIATION, INC.,
Petitioners,

v.

BELL ATLANTIC CORPORATION, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF FOR BELLSOUTH CORPORATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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INTEREST OF *AMICUS CURIAE*

With the consent of the parties,[1] *amicus curiae* BellSouth Corporation hereby submits this brief in support of respondents. BellSouth provides over 20 million telephone access lines in nine States. Like other telephone companies, BellSouth is subject to the ban on the provision of video programming contained in 47 U.S.C. § 533(b). In fact, BellSouth has successfully challenged § 533(b) on First Amendment grounds, and a federal court has enjoined the Government from enforcing the statute against BellSouth. *See BellSouth Corp. v. United States*, 868 F. Supp. 1335 (N.D. Ala. 1994), *appeal pending*, No. 94-7036 (11th Cir.).

INTRODUCTION AND SUMMARY OF ARGUMENT

This case presents the question of the constitutionality under the First Amendment of 47 U.S.C. § 533(b), which prohibits telephone companies from providing video programming to their local subscribers. The District Court and Court of Appeals in this case, like every other federal court to have considered the issue, invalidated the statute under the First Amendment. In the decision under review, the Fourth Circuit held that § 533(b) could not survive intermediate scrutiny, which petitioners contend is the appropriate level of judicial review. Although the statute fails any form of heightened review, § 533(b) is in fact subject to strict scrutiny, for several independent reasons. This Court should invalidate § 533(b) under the more exacting test, leaving intermediate scrutiny to be applied in the limited settings for which it was designed.

I. As a direct ban on speech alone, § 533(b) triggers strict scrutiny regardless of whether it is content-based. The statute is, in the words of the Federal Communications Commission, "a complete ban on editorial control [by a telephone company] over

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[1] Letters reflecting written consent of the parties to the submission of this brief have been filed with the Clerk of the Court.

video programming in [its] service area." Supp. Br. App. 4a.[2] Section 533(b) is analytically indistinct from a law prohibiting the owners of newspapers or magazines from exercising editorial control over any of the material carried in the pages of their publications. In fact, § 533(b) targets only the acts of editorial discretion that give cable television operators First Amendment protection in the first place. *See Turner Broadcasting Sys. v. FCC*, 114 S. Ct. 2445, 2456 (1994).

The First Amendment provides that "Congress shall make no law . . . abridging the freedom of speech, or of the press"; it does not refer only to restrictions "on the basis of content." No law runs more directly afoul of the constitutional proscription than a flat ban on a particular type of speech, and such laws have long been subject to exacting judicial scrutiny, whether or not they are content-based. *See, e.g., City of Ladue v. Gilleo*, 114 S. Ct. 2038, 2044-47 (1994); *Buckley v. Valeo*, 424 U.S. 1, 44-45 (1976) (*per curiam*); *Martin v. Struthers*, 319 U.S. 141, 145-49 (1943); *Schneider v. State*, 308 U. S. 147, 164-165 (1939). Indeed, this Court has made clear that even limitations on the *quantity* of a particular type of speech trigger First Amendment strict scrutiny. *E.g., Meyer v. Grant*, 486 U.S. 414, 419, 420, 424 (1988); *Buckley*, 424 U.S. at 15, 16, 17, 39, 44.

Section 533(b) prohibits telephone companies from engaging in an important and distinct type of expression. Accordingly, contrary to the claims of petitioners, the ban cannot properly be characterized as a "time, place, or manner" rule. *City of Ladue*, 114 S. Ct. at 2045; *Schad v. Borough of Mount Ephraim*, 452 U.S. 61, 75-76 (1981); *Martin v. Struthers*, 319 U.S. at 145-49. Time, place, or manner rules regulate the *noncommunicative aspects* of a speaker's activity, such as its loudness, in order to address some basic incompatibility between the conduct conveying

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[2] References to Federal Communications Commission's *Third Report and Order*, FCC 95-203 (May 16, 1995) are styled "Supp. Br. App. ___a." References to the decisions of the District Court and Court of Appeals, as reprinted in the Appendix to the Government's Petition for Certiorari in No. 94-1893, are styled as "Pet. App. ___a."

the communication and the primary activity occurring in the area in which the speaker wishes to speak. They may not, consistent with the First Amendment, ban a speaker from reaching his or her chosen audience. They may not single out particular speakers. Section 533(b) fulfills none of these requirements.

II. Section 533(b) also triggers strict scrutiny for the independent reason that it *is* indeed content-based. It prohibits telephone companies from offering only that "programming provided by, or generally considered comparable to programming provided by, a television broadcast station." 47 U.S.C. § 522(19). Section 533(b)'s prohibition depends on the expressive content of the image transmitted. In this respect, § 533(b) is akin to a law banning signs containing pictures "generally considered comparable to" those included in nationally distributed newspapers, but permitting signs containing text or other types of pictures. Such a law would clearly be content-based and subject to strict scrutiny.

Indeed, the District Court in this case observed that the statute is indistinguishable, in constitutional terms, from a scheme that compiled an exhaustive list of television shows from the 1984 editions of *TV Guide* and then prohibited telephone companies from providing those shows or any programming "generally considered comparable to" them. Pet. App. 85a-86a n.22. "[B]y any commonsense understanding of the term, the ban in this case is 'content-based.'" *City of Cincinnati v. Discovery Network, Inc.*, 113 S. Ct. 1505, 1516-17 (1993).

III. The definition of "video programming" is also so *vague* as to amount to a "know-it-when-we-see-it" standard which vests the FCC with impermissibly broad discretion over speech. There are no "'narrow, objective, and definite'" standards, *Forsyth County v. Nationalist Movement*, 112 S. Ct. 2395, 2401 (1992) (citation omitted), to constrain the Commission's determinations of what is and is not "video programming." Accordingly, § 533(b) is unconstitutional on its face.

IV. Finally, strict scrutiny is also warranted because § 533(b) is a ban on the speech of only a select group of speakers within a particular medium. *Minneapolis Star & Tribune v. Minnesota Comm'r of Revenue*, 460 U.S. 575 (1983). This case does not present the question of differential regulatory treatment of different types of media, as in *Turner Broadcasting*, but rather discriminatory treatment of certain speakers within a single medium.

ARGUMENT

I. AS A BAN ON SPEECH ALONE, SECTION 533(b) TRIGGERS STRICT SCRUTINY REGARDLESS OF WHETHER IT IS CONTENT-BASED

1. Section 533(b) bans telephone companies from providing their subscribers with video programming of the companies' own creation, editorial selection, or arrangement. This prohibition falls entirely on speech, and on nothing else. Section 533(b) does not, for example, prohibit telephone companies from transporting the video speech of others; rather, it bans telephone companies from providing video programming of their own. Nor does § 533(b) prohibit telephone companies from constructing or owning cable systems; instead, it bans them only from *speaking* on such systems.

As the District Court observed, the target of the ban is the "exercis[e of] editorial discretion" (Pet. App. 101a-102a) — the very act of expression that this Court has held to be protected by the First Amendment in its decisions involving cable television. *Turner Broadcasting*, 114 S. Ct. at 2456; *Los Angeles v. Preferred Communications, Inc.*, 476 U. S. 488, 494 (1986).

With respect to that protected category of speech, § 533(b) is a complete ban. As the FCC has explained, § 533(b) "prohibits [telephone companies] from choosing the video programming to be provided in their local exchange telephone service areas *altogether*." Supp. Br. App. 3a (emphasis in original). It is an "absolute ban" on the direct provision of video programming, *id.*

at 4a, and "a complete ban on editorial control over video programming in a telephone company's service area." *Id.*

Such "an absolute prohibition on a *particular type of expression* will be upheld only if narrowly drawn to accomplish a compelling governmental interest." *United States v. Grace*, 461 U.S. 171, 177 (1983) (emphasis added). This is true regardless of whether the regulation at issue is content-based. *E.g.*, *Simon & Schuster v. New York Crime Victims Bd.*, 502 U.S. 105, 126 (1991) (Kennedy, J., concurring in judgment).

Thus, this Court has invalidated "laws that foreclose an entire medium of expression," such as the display of signs on private property, even when they are "completely free of content or viewpoint discrimination." *City of Ladue v. Gilleo*, 114 S. Ct. 2038, 2045 (1994). "The danger [such laws] pose to the freedom of speech is readily apparent — by eliminating a common means of speaking, such measures can suppress too much speech." *Id.* This Court has also applied exacting scrutiny to strike down content-neutral prohibitions on the distribution of literature, *see Martin v. Struthers*, 319 U.S. 141, 145-49 (1943); *Schneider v. State*, 308 U. S. 147, 164-165 (1939), and on live entertainment. *Schad v. Borough of Mount Ephraim*, 452 U.S. 61, 75-76 (1981).[3]

Indeed, even content-neutral limitations on the *quantity* of a particular type of expression in which a speaker may engage — restrictions that fall short of an outright ban — trigger strict judicial scrutiny. In *Buckley v. Valeo*, 424 U.S. 1 (1976) (*per curiam*), for example, this Court applied "exacting scrutiny" to expenditure limitations that were "direct and substantial restraints on the quantity" of speech itself, *id.* at 39, 44-45, even though they were "neutral as to the ideas expressed." *Id.* at 39.

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[3] In each case the Court's scrutiny was exacting. *See, e.g.*, *Martin*, 318 U.S. at 146-49 (applying the tools of what since has become known as "strict scrutiny"); *Schad*, 452 U.S. at 68 (citing strict scrutiny cases). In the most recent case in this line, *City of Ladue*, 114 S. Ct. at 2044-46, this Court did not articulate a standard of review, but made clear that the intermediate scrutiny used for reasonable regulations of time, place, and manner is not appropriate for regulations that "foreclose an entire medium of expression."

Similarly, in *Meyer v. Grant*, 486 U.S. 414 (1988), this Court employed "exacting scrutiny" to strike down a ban on the use of paid petition circulators which "impose[d] a direct restriction which 'necessarily reduces the quantity of expression.'" *Id.* at 419, 420 (citing *Buckley*). This Court rejected the contention that the availability of other means of expression should reduce the degree of judicial scrutiny, explaining that the law "restrict[ed] access to the most effective, fundamental, and perhaps economical avenue of political discourse" and left open only "'more burdensome' avenues of communication." *Id.* at 424. "The First Amendment protects appellees' right not only to advocate their cause but also to select what they believe to be the most effective means for doing so." *Id.*[4]

2. Section 533(b) is wholly unlike the types of laws that this Court has reviewed under intermediate scrutiny. To begin with, § 533(b) is not a restriction on "conduct" that has merely an "incidental" effect on speech when applied to a particular example of that conduct that happens to be expressive. *See, e.g., Barnes v. Glen Theatre, Inc.*, 501 U.S. 560, 567, 570 (1991) (plurality opinion); *Clark v. Community for Creative Non-Violence*, 468 U.S. 288, 294, 298 (1984); *United States v. O'Brien*, 391 U.S. 367, 377 (1968). The *O'Brien* test itself applies only when "'speech' and 'nonspeech' elements are combined in the same course of conduct." 391 U.S. at 376. Section 533(b) does not involve "speech-plus," or conduct "intertwined," or "intermingled" with speech.[5] Where (as here) a ban falls on speech, and speech alone, *O'Brien's* version of intermediate scrutiny is

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[4] *See also Riley v. Nat'l Federation of Blind, Inc.*, 487 U.S. 781, 788-89 (1988) (explaining that "exacting First Amendment scrutiny" applies to "a direct restriction on the amount of money a charity can spend on fundraising activity" because such a law is "a direct restriction on protected First Amendment activity") (internal quotations omitted).

[5] *See American Radio Ass'n v. Mobile Steamship Ass'n*, 419 U.S. 215, 231 (1974); *Cameron v. Johnson*, 390 U.S. 611, 617 (1968); *Amalgamated Food Employees Union Local 590 v. Logan Valley Plaza, Inc.*, 391 U.S. 308, 313 (1968).

wholly inapplicable.[6]

Nor could § 533(b) qualify for intermediate scrutiny as a reasonable regulation of the time, place or manner of speech — the only basis on which petitioners urge intermediate scrutiny. Govt. Br. 23. There are three criteria for such rules, and § 533(b) fails each one.

First, this Court has made clear that time, place or manner rules must address "[s]ome basic incompatibility . . . between the communication and the primary activity of the area." *Greer v. Spock*, 424 U.S. 828, 843 (1976) (Powell, J., concurring). "[T]he question is whether 'the manner of expression is basically incompatible with the normal activity of a particular place at a particular time.'" *City of Lakewood v. Plain Dealer Pub. Co.*, 486 U.S. 750, 763 (1988) (citation omitted).

The Court's time, place or manner cases thus deal only with regulations that restrict the noncommunicative aspects of a speaker's activity, such as its loudness, in order to limit its nuisance impact on others. *See, e.g., Ward v. Rock Against Racism*, 491 U.S. 781, 791-92 (1989) (regulation of rock-concert volume to preserve sedate character of certain parts of Central Park and surrounding residential areas); *Frisby v. Schultz*, 487 U.S. 474, 486 (1988) (upholding regulation of picketing in front of a single residence to prevent intrusion on the privacy of that residence, because picketing focused upon individual residence is "fundamentally different from more generally directed means of communication that may not be completely banned"); *Members of the City Council of the City of Los Angeles v. Taxpayers for Vincent*, 466 U.S. 789, 805 (1984) (time, place or manner cases permit restriction of "certain methods of expression which may legitimately be deemed a public nuisance"); *Kovacs v. Cooper*, 336 U. S. 77 (1949) (prohibition on the use of "loud and raucous" sound trucks on municipal streets upheld because the use of such

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[6] *See also Cohen v. California*, 403 U.S. 15, 18 (1971) ("The only 'conduct' which the State sought to punish is the fact of communication. Thus, we deal here with a conviction resting solely upon 'speech,' . . . not upon any separately identifiable conduct . . . . *Cf. United States v. O'Brien.*").

trucks would leave the unwilling listener "practically helpless to escape this interference with his privacy" and could be thought a "nuisance").

Under this criterion, § 533(b) is plainly not a "time, place, or manner" rule. It prohibits telephone companies from engaging in an entire type of speech — video programming. Yet there is no allegation that the provision of such speech is somehow a "public nuisance." There can be no argument that providing video programming to individuals who wish to receive it is somehow incompatible with any other activity that the Government seeks to protect. Squarely applicable here is *Lovell v. Griffin*, 303 U.S. 444 (1938), where this Court made clear that a ban on handbilling could not be considered a "time, place, or manner" rule because "[t]here is . . . no restriction in [the] application [of the ban on circulars] with respect to time or place. It is not limited to ways which might be regarded as inconsistent with the maintenance of public order, or as involving disorderly conduct, the molestation of the inhabitants, or the misuse or littering of the streets." *Id.* at 451; *see also City Council of Los Angeles v. Taxpayers for Vincent*, 466 U.S. 789, 808 (1984) (under *Schneider v. State*, 308 U.S. 147 (1939), ban on leafleting in public streets cannot be considered time, place, or manner rule).

A second criterion for time, place, and manner rules is a corollary of the first: a regulation must apply evenhandedly to all speakers, because it must be concerned with the incompatibility of that *manner* of speech with some other activity in the same area. This Court thus has never deemed a law to be a "time, place, or manner" rule unless it applied evenhandedly to all speakers. *See City of Lakewood*, 486 U.S. at 763 ("In contrast [to a time, place, or manner rule], a law or policy permitting communication in a certain manner for some but not for others raises the specter of content and viewpoint censorship."). Indeed, speaker-specificity in a speech regulation independently triggers strict scrutiny. *See* Part IV, *infra*. Under § 533(b), of course, only telephone companies are forbidden from providing video programming directly to consumers.

The third criterion is that time, place, or manner rules must permit the speaker to communicate his or her chosen content to his or her desired audience. For example, in *Ward v. Rock Against Racism, Inc.*, 491 U.S. 781 (1989), this Court explained that the regulation on loudness had "no material impact on any performer's ability to exercise complete artistic control over sound quality" of the performance delivered to its audience. *Id.* at 802. Similarly, in *Heffron v. International Society for Krishna Consciousness*, 452 U.S. 640 (1981), the respondents, who were permitted to sell or distribute literature only from a fixed location (a booth) within a state fairground, were nonetheless able to hand the same literature to their desired audience within the very forum in question. *See id.* at 655. And in *Grayned v. City of Rockford*, 408 U.S. 104 (1972), this Court upheld a conviction of a protester under an antinoise ordinance that applied in areas next to schools when classes were in session. The ordinance, however, permitted even noisy demonstrations "before or after the school session, while the [same] student/faculty 'audience' enters and leaves the school." *Id.* at 120.[7]

By contrast, § 533(b) prohibits telephone companies from using the Nation's most important medium of expression to speak directly with their most natural audience: customers in their local service areas. If § 533(b) were characterized as a "time, place, or manner" restriction, any prohibition on speech could be similarly described. For example, the ban on the payment of petition circulators struck down in *Meyer v. Grant*, 486 U.S. 414 (1988), could be deemed a mere limitation on the manner of communicating with voters. Even a ban on book publishing could be characterized as a prohibition on a single "manner" of printed speech. Such reasoning would eviscerate the First Amendment.

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[7] In *City Council of Los Angeles v. Taxpayers for Vincent*, 466 U.S. 789 (1984), this Court noted that there was no evidence that "appellees' ability to communicate effectively is threatened." *Id.* at 812; *see also Frisby v. Schultz*, 487 U.S. 474, 483, 484 (1988) (noting that the ban on residential picketing did not impair communication); *Ladue*, 114 S. Ct. at 2045-46 (noting that the laws in *Vincent* and *Frisby* did not foreclose speech).

3. Lastly, § 533(b) is not an access rule about sharing the use of finite capacity, like the must-carry rules at issue in *Turner Broadcasting*. This Court noted that the must-carry rules "do not produce any net decrease in the amount of available speech," "leave cable operators free to carry whatever programming they wish on all channels not subject to the must-carry requirements," and do not "diminish the free flow of information and ideas." 114 S. Ct. at 2462, 2466. The must-carry rules do not ban a cable operator from speaking. By contrast, § 533(b) is a "must *not* carry" rule for telephone companies.

II. SECTION 533(b) IS INDEPENDENTLY SUBJECT TO STRICT SCRUTINY AS A CONTENT-BASED RESTRICTION ON SPEECH

Section 533(b) also triggers strict scrutiny for the independent reason that it is content-based.

A. The Statutory Definition of "Video Programming" Is Content-Based

1. This Court has made clear that strict scrutiny applies to prohibitions on speech that by their very terms require examination of the content of communication. For example, in *FCC v. League of Women Voters*, 468 U.S. 364 (1984), this Court invalidated a ban on "editorials" by public broadcast stations receiving government funds. This Court observed that "the scope of [the] ban is defined solely on the basis of the content of the suppressed speech": "in order to determine whether a particular statement by station management constitutes an 'editorial' proscribed by [the statute], enforcement authorities must necessarily examine the content of the message that is conveyed." *Id.* at 383. In *City of Cincinnati v. Discovery Network, Inc.*, 113 S. Ct. 1505, 1513, 1516-17 (1993), this Court held that the distinction between "commercial handbills" and "newspapers" is content-based, even though "[t]here is no doubt a 'common sense' basis for distinguishing between the two." The Court explained that

"'official scrutiny of the content of publications . . . is entirely incompatible with the First Amendment.'" *Id.* at 1514 n.19.

And in *Burson v. Freeman*, 504 U.S. 191 (1992), this Court held that a statute prohibiting the solicitation of votes and the display of campaign materials within 100 feet of a polling place was content-based. A plurality explained that "[w]hether individuals may exercise their free speech rights near polling places depends entirely on whether their speech is related to a political campaign. The statute does not reach other categories of speech, such as commercial solicitation, distribution, and display." *Id.* at 197. Accordingly, the plurality indicated that the statute's *terms*, which "distinguish[ed] among types of speech," "require[d] that the statute be subjected to strict scrutiny." *Id.* at 207.[8]

2. Section 533(b) falls into this category of forbidden laws. The speech banned by § 533(b) is defined exclusively in content-based terms: "programming provided by, or generally considered comparable to programming provided by, a television broadcast station." 47 U.S.C. § 522(19).[9] The scope of § 533(b)'s

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[8] This Court's decision in *Turner Broadcasting Sys., Inc. v. FCC*, 114 S. Ct. 2445 (1994), is to the same effect. The Court did not find the must-carry rules to be content-based, but only because the rules did not "favor programming of a particular subject matter, viewpoint, or *format*." *Id.* at 2461 (emphasis added). The Court observed that, with respect to the must-carry rules, "the extent of the interference [with speech] does not depend on the content of the cable operators' programming." *Id.*; *see also id.* (must-carry rules apply "irrespective of the programming [cable operators] choose to offer"). By contrast, § 533(b) is content-based because its application depends completely on the communicative substance of the programming that a telephone company chooses to provide.

Four Justices would have invalidated even the must-carry rules as an impermissible content-based regulation of speech. *See* 114 S. Ct. at 2476-79 (O'Connor, J., joined by Scalia, Thomas, and Ginsburg, JJ., concurring in part and dissenting in part); *id.* at 2481 (Ginsburg, J., concurring in part and dissenting in part).

[9] Notably, the original FCC regulations forbade telephone companies from providing "CATV service," defined not in terms of speech content but rather as a "facility" for "receiv[ing]" broadcast signals and "distribut[ing]" them to subscribers. *Second Report on CATV Systems*, 2 FCC 2d 725 (1966).

prohibition turns on an assessment of the expressive content and communicative effect of the speech.

The District Court recognized that § 533(b), "as written and enacted, requires reference to the content of the relevant message in order to determine whether a particular visual image qualifies under the statutory definition of 'video programming.'" Pet. App. 84a. For example, § 533(b) permits telephone companies to provide local subscribers with visual images such as the face of a clock reflecting the current time, or the image of a person speaking to the viewer by picture-phone. *Id.* at 85a. But telephone companies may not provide programming comparable to that provided by a television broadcast station in 1984 (the year of § 533(b)'s enactment), like TV shows and movies. As the District Court concluded, "there is simply no way that § 533(b) . . . can be applied without reference to the content of the message being conveyed." *Id.*

In fact, the Government conceded in the District Court that a ban enumerating 1984 television programming show-by-show — "the MacNeil/Lehrer Newshour," "news programs," "sitcoms," and so on — would be content-based and "would not be constitutional." *Id.* at 85a-86a n.22. The District Court asked, "If you got out the T.V. Guide for 1984 you could end up with a generic list of all the stuff that [was] on television [that year] . . . . What's the difference [between that and the statutory definition of video programming]?" *Id.* Neither petitioner had any response.

3. The Government admits that the statute requires the FCC, in determining whether a particular video image is prohibited, to judge whether it is "'comparable to [the programming] provided by broadcast television stations in 1984.'" Govt. Br. 21 (quoting *Video Dialtone Order*, 7 FCC Rcd 5781, 5820 (1992)). The Government contends, however, that "the statute [merely] distinguishes the one-way, non-interactive television technology familiar to Congress in 1984 from other forms of speech that were under development at the time . . ., such as interactive video and videotext." *Id.*

But the statute simply does not draw this mechanically-applicable, content-neutral technological distinction between one-way transmission and two-way interactive communication. Many

kinds of one-way transmission are permitted by § 533(b), and many kinds of two-way interactive communication are prohibited by the statute.

The Cable Act itself makes clear that the inclusion of a two-way capability does not take programming out of the ban. The Act defines "cable service" to include only "one-way . . . video programming," 47 U.S.C. § 522(6)(A) — indicating that one-way transmissions are but a subset of "video programming." Accordingly, the FCC has explained that two-way video services, like interactive television shows, would nonetheless be prohibited by § 533(b). *Video Dialtone Order*, 7 FCC Rcd at ¶ 75.

Conversely, the one-way nature of certain transmissions does not necessarily make them "video programming." The Commission has explained, for example, that "one-way . . . news services and stock market information, pay-per-view, one-way transmission of video games and computer software, on-line airline guides, and other programming services" are not "video programming," notwithstanding their prominent video components. *Id.* at ¶ 77.

Hence, the definition of "video programming" does not hinge on a technical distinction between one-way and two-way communication. Rather, it operates according to an inherently content-based inquiry: whether particular video images are sufficiently "comparable" to broadcast television programming. For example, a picture of an automobile on a television screen might be a display generated by a video game (not "video programming," even if transmitted over telephone lines to a subscriber), or part of a video catalogue (not "video programming"), or a scene in a television show ("video programming," unless, for instance, the scene is an excerpt used as part of an interactive multimedia presentation). The statute's line between the forbidden and the permissible is drawn in terms of the speaker's infusion of creativity (did the speaker create or structure the image or sequence of images so that the result is "comparable" to broadcast television circa 1984?) and the speech's communicative impact on the minds of viewers (does the audience perceive the image as "comparable" to broadcast television?).

Those distinctions simply cannot be made without reference to the content of the programming. *See* J.A. 157-61 (Affidavit of William E. Lee ¶¶ 28-35).[10]

4. Echoing its mischaracterization of § 533(b) as a "time, place, or manner" rule, the Government also contends that § 533(b) is not content-based because it is a regulation on the "'mode of delivery of the speech.'" Govt. Br. 20-21. This Court rejected the parallel argument both in *Burson*, 504 U.S. at 197, and in *Discovery Network*, 113 S. Ct. at 1516. Section 533(b) does not ban the delivery of information by wires, or even in video form on a television screen. Rather, it bans only the expressive packaging of *certain* video images, depending on their content. Section 533(b) can no more be justified as a restriction on the "mode of delivery" of speech than the ban on editorials in *FCC v. League of Women Voters* could be justified as a restriction on the delivery of information through the "mode" of an editorial, or the prohibition on unsigned campaign literature in *McIntyre v. Ohio Elections Comm'n*, 115 S. Ct. 1511 (1995), could be upheld as a limit on the "mode" of anonymous speech.[11]

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[10] In the Court of Appeals, NCTA argued that § 533(b) was "content-neutral" because it drew a "market" distinction between "cable service" and telephony. This claim is unsupportable. The Cable Act uses the phrases "cable operator," "cable service," and "video programming" separately, not interchangeably. In § 522(19), Congress provided a specific definition of "video programming." Thus, the FCC was certainly correct in the *Video Dialtone Order* when it rejected the argument that Congress meant to equate "video programming" with "cable service." 7 FCC Rcd at ¶ 75 n.194. In any event, § 533(b) would still be subject to strict scrutiny, even if it were a "market-based" ban. *See Arkansas Writers' Project, Inc. v. Ragland*, 481 U.S. 221, 230, 232 (1987) (market-based measure which exempted certain magazines from tax in order "to encourage 'fledgling' publishers" was invalid because, "[i]n order to determine whether a magazine is subject to sales tax, . . . 'enforcement authorities must necessarily examine the content of the message that is conveyed'") (citation omitted).

[11] Because § 533(b) regulates speech according to its *expressive* content, it is not akin to the limitations on *nonexpressive* aspects of photographic reproductions, like their size and color, upheld in *Regan v. Time, Inc.*, 468 U.S. 641 (1984). Instead, § 533(b) is like the statutory provision invalidated

5. The Government further suggests that § 533(b) is content-neutral because it does not "contain any reference to the *subject matter* of television programs" or to the particular "*ideas* expressed in the message." Govt. Br. 21, 22 (emphases added). But this is not the test. The First Amendment requires that content-based laws be subject to strict scrutiny even if they are neutral as to subject matter or viewpoint. Thus, the prohibition invalidated in *FCC v. League of Women Voters* applied to all editorials regardless of subject matter or viewpoint. "'Above all else, the First Amendment means that government has no power to restrict expression because of its message, its ideas, its subject matter, *or its content*.'" *Ragland*, 481 U.S. at 229-30 (quoting *Police Dept. of Chicago v. Mosley*, 408 U.S. 92, 95 (1972) (emphasis added)); *see also Burson*, 504 U.S. at 197; *Boos v. Barry*, 485 U.S. 312, 319 (1988) (plurality opinion).

For all these reasons, § 533(b) is subject to strict scrutiny as a content-based ban on speech.

B. Neither Congress' Motives Nor Post Hoc Justifications Can Alter the Conclusion That Strict Scrutiny Applies

1. The most novel argument advanced by the Government is that, even though by its terms § 533(b) bans speech according to content, intermediate scrutiny is nonetheless appropriate because the statute can be "'*justified* without reference to the content of regulated speech.'" Govt. Br. 22 (quoting *City of Renton v.*

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in *Regan*, which prohibited the publication of any photograph of U.S. currency except for educational, historical, and newsworthy purposes: "A determination concerning the newsworthiness or educational value of a photograph cannot help but be based on the content of the photograph . . . . Regulations which permit the Government to discriminate on the basis of the content of the message cannot be tolerated under the First Amendment." *Id.* at 648-49.

Playtime Theatres, Inc., 475 U.S. 41, 48 (1986)).[12]

This Court, however, has flatly rejected the suggestion that a law otherwise subject to strict scrutiny should receive lesser scrutiny simply because a reason for the law can, with enough creativity, be devised without reference to the content of speech. For example, this Court applied strict scrutiny to the facially content-based laws at issue in *FCC v. League of Women Voters*, 468 U.S. 364, 383 (1984), *Burson v. Freeman*, 504 U.S. 191, 197, 207 (1992), *Arkansas Writers' Project, Inc. v. Ragland*, 481 U.S. 221, 230 (1987), and *Regan v. Time, Inc.*, 468 U.S. 641, 648-49 (1984), without pausing to consider possible content-neutral justifications. *Burson v. Freeman* is illustrative: There, this Court applied strict scrutiny even though the State asserted an interest not in suppressing communication but rather in preventing fraud and intimidation by campaigners who might "physically interfere[] with electors attempting to cast their ballots." 504 U.S. at 209 n.11. *See also Cincinnati v. Discovery Network*, 113 S. Ct. at 1516-17 (irrelevant that "the *justification* for the regulation is content neutral," because "the *very basis* for the regulation is the difference between ordinary newspapers and commercial speech. . . . [W]hether any particular newsrack falls within the ban is determined by the content of the publication resting inside that newsrack") (emphasis added).

Thus, in *Turner Broadcasting System, Inc. v. FCC*, 114 S. Ct. 2445 (1994), this Court confirmed that strict scrutiny is triggered by laws like § 533(b) that by their terms proscribe speech on the basis of its content — *without further inquiry into legislative purpose*. This Court explained that, "while a content-based purpose may be sufficient in certain circumstances to show

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[12] The Government notes that the District Court followed its view of *Renton*, but fails to mention that the court expressed grave "misgivings" about this interpretation of the First Amendment, noting that it was a "significant retreat from the traditional content-based/content-neutral distinction," Pet. App. 89a, 93a, and predicting that its novel approach would "gut[]" the distinction between content-based and content-neutral restrictions of speech. *Id.* at 90a.

that a regulation is content-based, it is not necessary to such a showing in all cases," since "'illicit legislative intent is not the *sine qua non* of a violation of the First Amendment.'" *Id.* at 2459 (citation omitted). "Nor will the mere assertion of a content-neutral purpose be enough to save a law which, *on its face*, discriminates based on content." *Id.* (emphasis added). This Court looked to the justifications proffered by the Government only *after* determining that the rules were not "on their face" content-based. *Id.* at 2460.

First Amendment jurisprudence would look very different indeed if the mere invocation of a content-neutral justification were enough to avoid strict scrutiny, for it is "invariably the case [that] the government can frame the interest served by [a restriction] in essentially speech-neutral terms." *Quincy Cable TV, Inc. v. FCC*, 768 F.2d 1434, 1451 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1169 (1986).[13]

2. The Government's argument rests on a misapplication of this Court's decision in *Renton* and similar cases. In reviewing laws that are *not* on their face content-based bans on speech and thus do not otherwise trigger strict scrutiny, this Court has asked whether such laws, although *ostensibly* based on noncommunicative attributes of speech, should *nevertheless* be subjected to strict scrutiny because, in reality, they are attempts to suppress speech on the basis of content. But this is a one-way ratchet, for this Court has reserved such analysis for laws that are aimed, as

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[13] For example, in *Simon & Schuster*, 502 U.S. at 108, 118, the State asserted an interest in compensating the victims of crime; in *Austin v. Michigan Chamber of Commerce*, 494 U.S. 652, 659-60 (1990), the State asserted an interest in preventing the appearance or reality of corporate corruption of the political process; in *Riley*, 487 U.S. at 789, the State asserted an interest in preventing fraud; in *Boos v. Barry*, 485 U.S. at 322, the Government asserted an interest in protecting the dignity of foreign diplomatic personnel; in *Pacific Gas & Electric*, 475 U.S. at 19, the State asserted an interest in effective ratemaking proceedings; and in *Consolidated Edison Co. of New York v. Public Service Comm'n*, 447 U.S. 530, 540-43 (1980), the State asserted interests in protecting individual privacy, allocating limited resources in the public interest, and protecting utility ratepayers.

a facial matter, at the "nonspeech" elements of an expressive act, such as its noise level, *see Ward*, 491 U.S. at 791-92, or its location within a community. *See Renton*, 475 U.S. at 46, 54.[14]

In particular, *Renton* — on which the Government would rely — concerns "time, place, and manner rules," 475 U.S. at 46, not a law like § 533(b), which not only directly bans speech as such, but also uses the "content" of speech to define the very substance of what is banned. The Renton ordinance did "not ban adult theaters altogether," 475 U.S. at 46, and in fact left adult theaters undiluted freedom "to open and operate . . . within the [same] city." *Id.* at 54. It "merely provide[d] that such theaters may not be located within 1,000 feet away from any residential zone, single- or multiple-family dwelling, church, park, or school." *Id.* at 46. The ordinance was no more objectionable than a "content-based" public library rule assigning books about geometry and books about geology to different shelves.

There is a world of difference between such "traffic cop" rules that make innocent reference to content in the course of non-intrusively regulating *when*, *where*, and *how* speech directed to a given audience may occur, and prohibitions that use content to determine *whether* the speech in question may be provided to that audience *at all*. Section 533(b), with its ban on "home-town" video programming, is akin to the city-wide ban on adult theaters that *Renton* expressly left subject to strict scrutiny.[15]

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[14] In *R.A.V. v. City of St. Paul*, 112 S. Ct. 2538 (1992), for example, this Court described the "justified-without-reference" test as applicable only to "time, place, or manner" restrictions, *see id.* at 2544, and refused to consider the city's interests as a rationale for reducing the strict scrutiny otherwise triggered by "a facially content-based statute." *Id.* at 2549; *see also Simon & Schuster, Inc. v. Members of New York State Crime Victims Bd.*, 502 U.S. 105, 116, 122 n.* (1991) (holding that "Son of Sam" law was "content-based," without resolving the question whether the statute had a "content-neutral" justification under *Ward* and *Renton* — demonstrating that the analysis in *Ward* and *Renton* is not the exclusive means for determining whether legislation is content-based).

[15] Thus, in *Young v. American Mini-Theatres, Inc.*, 427 U.S. 50 (1976), a decision that "largely dictated" the Court's reasoning in *Renton*, 475 U.S.

3. The Government nonetheless insists that strict scrutiny is inappropriate here because § 533(b) supposedly "is not motivated by any hostility to any message," Govt. Br. 20, and was not "designed" to suppress speech. *Id.* According to the Solicitor General, the "objective" (*id.*) and "purpose" (*id.* at 22) of Congress were entirely pure.

To begin with, these assertions are far too speculative to support a facially content-based restriction on speech. Ascertaining the "motive" and "purpose" of the 1984 Congress — as if it were a unitary entity — is an enterprise fraught with difficulty. *See, e.g., Edwards v. Aguillard*, 482 U.S. 578, 636-39 (1987) (Scalia, J., dissenting). And the effect on speech is the same regardless of the subjective intent of individual Members of Congress.

More fundamentally, the bright line rule that "a regulation that *on its face* draws content distinctions" ordinarily triggers strict First Amendment scrutiny, is essential to eliminate the risk of the censorship of ideas. *Ladue*, 114 S. Ct. at 2047 (O'Connor, J., concurring) (emphasis added). Thus, this Court has consistently held that strict scrutiny does not depend on a showing that

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at 46, this Court also upheld an adult theater zoning ordinance. But a plurality pointedly noted that "[t]he situation would be quite different if the ordinance had the effect of suppressing, or greatly restricting access to, lawful speech." 427 U.S. at 71 n.35; *see also id.* at 79 (Powell, J., concurring) (ordinance did not involve "any significant overall curtailment of adult movie presentations"); *Schad v. Borough of Mount Ephraim*, 452 U.S. 61, 76 (1981) ("Here, the Borough totally excludes all live entertainment, including non-obscene nude dancing that is otherwise protected by the First Amendment. As we have observed, *Young* . . . did not purport to approve the total exclusion from the city of theaters showing adult, but not obscene materials. It was carefully noted in that case that the number of regulated establishments was *not* limited.") (emphasis added). Nor did *Renton* or *Young* involve outright bans on the local exhibition of sexually explicit films; in such a case, even the city's invocation of "secondary effects" could not save the ban from strict scrutiny. *Cf. Erznoznik v. City of Jacksonville*, 422 U.S. 205, 213 (1975). Far from questioning these precedents, *Renton* expressly reaffirmed them, explaining that the narrowness of the zoning rule in that case "avoid[ed] the flaw that proved fatal . . . in *Schad* and *Erznoznik*." 475 U.S. at 52.

Congress intended to silence communication of a particular message.[16] Indeed, in *O'Brien* itself this Court denounced inquiry into legislative purpose as "a hazardous matter." 391 U.S. at 383; *see also id.* at 383-84 n.30.

The hazards are apparent here. The Government's conjecture notwithstanding, it appears that, if anything, Congress proceeded on decidedly content-based assumptions about the value of telephone company speech. The key House Report justified § 533(b)'s ban on video programming on the ground that it would "foster the availability of a 'diversity of *viewpoints*' to the listening audience." H.R. Rep. No. 934, 98th Cong., 2d Sess. 31 (1984) (emphasis added). In this very litigation, petitioners have defended § 533(b) on the ground that, "although the telephone companies contemplate First Amendment activities, they would not be the same as those of newspapers," Govt. Reply Br. in Ct. App. 4 (Dec. 30, 1993); that the telephone companies had made "no claim that the content of [their] channels would be unique," NCTA Reply Br. in Ct. App. at 7 (Dec. 30, 1993); and that "it is fanciful to believe that Bell Atlantic . . . would make available a whole range of programming (*e.g.*, movies) not offered by independent cable operators." *Id.*

The assumption that telephone companies' involvement in the cable industry will, on balance, subtract from, rather than add to, "diversity" — not simply of *ownership* but also of *viewpoint* — is *necessarily* based in part on the expected content of their speech. *See Pacific Gas & Elec. Co. v. Public Utilities Comm'n of California*, 475 U.S. 1, 12 (1986) (holding that a law mandating

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[16] In *Discovery Network*, for example, this Court acknowledged that "there is no evidence that the city has acted with animus toward the ideas contained within respondents' publications." 113 S. Ct. at 1516. Nonetheless, this Court found the city's "mens rea" irrelevant. *Id.*; *see also Simon & Schuster, Inc. v. Members of New York State Crime Victims Bd.*, 502 U.S. 105, 117 (1991) ("'even regulations aimed at proper governmental concerns'" — as opposed to the suppression of ideas — are subject to strict scrutiny if they fall "only on speech of a particular content"); *Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue*, 460 U.S. 575, 592 (1983).

access to a utility company's billing envelopes that was designed to "offer the public a greater variety of views" was content-based and was invalid under the First Amendment).

In sum, none of the Government's arguments warrants the application of less than strict scrutiny.

III. SECTION 533(b) IS INVALID BECAUSE IT VESTS AN ADMINISTRATIVE AGENCY WITH IMPERMISSIBLE DISCRETION OVER SPEECH

1. There is yet a third reason why § 533(b) must be subjected to more than intermediate scrutiny and necessarily violates the First Amendment. Administrative regulation of speech is invalid *per se* unless it operates according to content-neutral standards that are "'narrow, objective, and definite.'" *Forsyth County v. Nationalist Movement*, 112 S. Ct. 2395, 2401 (1992) (citation omitted). "The reasoning is simple: If [such a] scheme 'involves appraisal of facts, the exercise of judgment, and the formation of an opinion' by the licensing authority, 'the danger of censorship and of abridgment of our precious First Amendment freedoms is too great' to be permitted." *Id.* at 2401-02 (citations omitted). The possibility of case-by-case judicial review cannot save such a statute, since without narrow guideposts, "post hoc rationalizations by the licensing official and the use of shifting or illegitimate criteria are far too easy, making it difficult for courts to determine in any particular case whether the licensor is permitting favorable, and suppressing unfavorable, expression." *City of Lakewood v. Plain Dealer Pub. Co.*, 486 U.S. 750, 758 (1988).[17]

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[17] *See also City of Cincinnati v. Discovery Network, Inc.*, 113 S. Ct. 1505, 1513 n.19 (1993); *Interstate Circuit v. Dallas*, 390 U.S. 676, 683-85 (1968); *Staub v. City of Baxley*, 355 U.S. 313, 322 (1958); *Lovell v. City of Griffin*, 303 U.S. 444, 451 (1938).

2. Section 533(b) violates this principle. The substantial latitude left the FCC in appraising facts, exercising judgment, and forming an opinion as to whether particular video images amount to "video programming" is impermissible under the First Amendment. For example, the FCC has already recognized that, although "an educational multimedia presentation" is *not* "video programming," "the simple inclusion of *some* textual information [could not] transform a severable video program into a permissible multimedia presentation." *Video Dialtone Order*, at ¶ 76 n.196. Left unsaid, and unknowable from the statute's language, is where the line will be drawn on the spectrum that ranges from "severable video programs," at one end, to "multimedia presentations," on the other. Indeed, the Commission has admitted that "it is not possible to classify with precision all potential services" to determine whether they qualify as "video programming" and has warned that "the examples we now set forth are by no means exhaustive." *Id.* at ¶ 74.

Tellingly, the government itself found the phrase "video programmers" "too vague and ambiguous" to permit an answer to one of the paragraphs in the plaintiffs' complaint in this case. *See* J.A. 20. Even if a rough-and-ready "I know it when I see it" approach could be deemed sufficient for separating hard-core pornography from protected speech, *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (Stewart, J., concurring), it surely is not adequate for classifying different categories of protected speech.

3. The dangers of such administrative discretion cannot be brushed aside. If the FCC were to find that a video image provided by a telephone company amounted to "video programming," it could seek a federal criminal prosecution pursuant to 47 U.S.C. § 401(c), or initiate administrative forfeiture proceedings of its own. Indeed, a prior case involving the constitutionality of § 533(b) under the First Amendment, in which the court did not reach the issue, began as an FCC enforcement proceeding triggered by complaints by a competing cable company. *See Northwestern Indiana Telephone Co. v. FCC*, 824 F.2d 1205 (D.C. Cir.), *appeal after remand*, 872 F.2d 465 (D.C. Cir. 1987), *cert. denied*, 493 U.S. 1035 (1990). The

telephone company was a tiny independent — a family-run business — that had wired only 500 homes for cable. Nonetheless, the FCC imposed a $20,000 civil forfeiture and awarded the cable company damages. *Comark Cable Fund III*, 100 F.C.C.2d 1244 (1985).

The broad discretion afforded the FCC by § 533(b) renders the statute invalid on its face.

IV. SECTION 533(b) TRIGGERS STRICT SCRUTINY FOR THE FURTHER REASON THAT IT SINGLES OUT TELEPHONE COMPANIES FOR A SPECIAL BAN ON SPEECH

Even apart from the reasons already adduced, strict scrutiny is required because § 533(b) bans the speech of only a single class of speakers. It bans expression only by speakers that began as telephone companies, but now are able to provide cable service, while leaving speakers that began as cable companies (but now are able to provide telephone service over their networks) free to speak. Section 533(b) is thus akin to a law prohibiting a specific group from participating in a parade down Main Street.

Under established constitutional principles, the selectivity of § 533(b) calls for a compelling justification by the Government. "In the realm of protected speech, the legislature is constitutionally disqualified from dictating the subjects about which persons may speak *and the speakers who may address a public issue.*" *First National Bank of Boston v. Bellotti*, 435 U.S. 765, 784-85 (1978 (emphasis added).[18]

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[18] *See also Simon & Schuster*, 502 U.S. at 117 ("[t]he Government's power to impose content-based financial disincentives on speech surely does not vary with the identity of the speaker"); *Philadelphia Newspapers, Inc. v. Hepps*, 475 U.S. 767, 777 (1986) (describing *Bellotti* as involving a "speaker-based restriction"); *Austin v. Michigan Chamber of Commerce*, 494 U.S. 652, 680-81 (1990) (Scalia, J., dissenting) (noting that corporate nature of speaker does not justify suppressing its speech); *Perry Education Ass'n*, 460 U.S. at 55 (restricting the access of a "single class of speakers" to a particular avenue of communication can be justified only by "compelling reasons"); *Madison*

This case does not involve evenhanded regulation of all members of a single medium, as in *Turner Broadcasting*, and *Leathers v. Medlock*, 499 U.S. 439 (1991). Section 533(b) applies not to all would-be providers of video programming over their networks, but only to those entities that began as telephone companies. Yet able companies increasingly provide many types of telephone services. *See, e.g.*, J.A. 187-88, 202-04; *NCTA v. FCC*, 33 F.3d 66, 69 (D.C. Cir. 1994) (explaining the "blurring" of the line between voice and video technologies); NCTA Br. 9, 37 & n.31 (noting the entry of cable companies into telephony). Nor does § 533(b) bar electric utilities from providing video programming directly to their customers, even though such speech would be subject to exactly the same arguments as those advanced by petitioners here. In fact, "[m]ost utility poles and conduits are owned not by telephone companies but by other utilities, and these utilities may and do provide cable television themselves, in competition with cable companies." JA 185-86; *see also id.* at 198-99.

This case involves discrimination among speakers within a single medium of the kind that this Court has always considered invalid. In *Minneapolis Star & Tribune v. Minnesota Comm'r of Revenue*, 460 U.S. 575 (1983), for example, this Court invalidated a special paper and ink tax "because it targets a small group of newspapers." *Id.* at 591. The Court did not "impugn the motives of the Minnesota Legislature," but it explained that "to tailor the tax so that it singles out a few members of the press presents such a potential for abuse that no interest suggested by Minnesota can justify the scheme." *Id.* at 592. Similarly, in *Grosjean v. American Press Co.*, 297 U.S. 233 (1936), this Court struck down

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School District v. Wisconsin Employment Relations Comm'n, 429 U.S. 167, 176 (1976) (public board may not "discriminate between speakers" at its meetings); *Police Department of Chicago v. Mosley*, 408 U.S. 92, 96 (1972) ("[W]e have frequently condemned . . . discrimination among different users of the same medium for expression").

a tax on publications with weekly circulations above 20,000, which fell on 13 of the approximately 135 newspapers in the State.

This Court reaffirmed this principle in *Leathers*, explaining that "narrow targeting of individual members" of a particular medium "offends the First Amendment." 499 U.S. at 446; *see also id.* at 447 ("A tax is . . . suspect if it targets a small group of speakers"). In contrast, in *Turner Broadcasting* this Court emphasized that "the must-carry provisions are not structured in a manner that carries the inherent risk of undermining First Amendment interests. The regulations are broad-based, applying to almost all cable systems in the country, rather than just a select few." 114 S. Ct. at 2468. "As a result," this Court concluded, "the provisions do not pose the same dangers of suppression and manipulation that were posed by the more narrowly targeted regulations in *Minneapolis Star*." *Id.*

Here, the selective ban imposed by § 533(b) applies only to certain providers of video programming — telephone companies. It is significantly more burdensome than the discriminatory taxes at issue in *Minneapolis Star* and other cases where this Court has applied strict scrutiny. And it is not "broad-based" in a way that avoids the "inherent risk of undermining First Amendment interests." *Turner Broadcasting*, 114 S. Ct. at 2468.

The discriminatory nature of § 533(b) provides an additional reason that strict scrutiny is warranted.

CONCLUSION

For these independent reasons, § 533(b) is subject to strict judicial scrutiny. Because no party before the Court suggests that the statute can survive such scrutiny, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted.

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In the Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, ET AL.;
NATIONAL CABLE TELEVISION ASSOCIATION, INC.
Petitioners,

v.

THE CHESAPEAKE AND POTOMAC TELEPHONE
COMPANY OF VIRGINIA, *ET AL.*, *Respondents*.

On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

BRIEF FOR *AMICI CURIAE* UNITED STATES TELEPHONE ASSOCIATION, NATIONAL TELEPHONE COOPERATIVE ASSOCIATION, ORGANIZATION FOR THE PROTECTION AND ADVANCEMENT OF SMALL TELEPHONE COMPANIES, AMERITECH CORPORATION, CINCINNATI BELL, FRONTIER CORPORATION, ILLINOIS CONSOLIDATED TELEPHONE COMPANY, NYNEX CORPORATION, PACIFIC TELESIS GROUP, SBC COMMUNICATIONS INC., AND THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY, IN SUPPORT OF RESPONDENTS

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INTEREST OF THE AMICI CURIAE

Amici curiae are companies (and industry associations whose members are companies) that provide telecommunications services to the general public, including local telephone service regulated as common carriage under state law and the federal Communications Act of 1934.[1] *Amici* file this brief in opposition to petitioners' arguments that 47 U.S.C. § 533(b), which prohibits telephone companies from providing "video programming" directly to subscribers within their service areas, can be reconciled with the First Amendment.[2]

Like respondent Bell Atlantic, each *amicus* here has successfully brought suit to vindicate its First Amendment right to offer video programming. In ten different cases, federal courts across the country have unanimously held without dissent that Section 533(b) violates the First Amendment.[3] Petitioners would have this Court

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[1] *Amici* United States Telephone Association, National Telephone Cooperative Association, and Organization for the Protection and Advancement of Small Telephone Companies are industry associations whose members — approximately 1400 companies — include virtually all of the traditional local telephone companies in the United States. *Amici* Ameritech Corporation, Cincinnati Bell, Frontier Corporation, Illinois Consolidated Telephone Company, NYNEX Corporation, Pacific Telesis Group, SBC Communications Inc., Southern New England Telephone Company, are some of the largest companies whose affiliates or subsidiaries are engaged in the business of providing communications services, including local telephone service. Together with respondents and *amici* U S West, Inc., BellSouth Corporation, East Ascension Telephone Company, and GTE Corporation, *amici* represent virtually every company subject to the free speech restriction in 47 U.S.C. § 533(b).

[2] The parties' letters of consent to the filing of this brief have been filed with the Clerk pursuant to Rule 37.3 of the Rules of this Court.

[3] *U S West, Inc.* v. *United States*, 48 F.3d 1092 (9th Cir. 1994), pet. for cert. filed, No. 95-315 (Aug. 23, 1995); *Pacific Telesis Group* v. *United States*, 48 F.3d 1106 (9th Cir. 1994), pet. for cert. filed, No. 95-315 (Aug. 23, 1995); *Southern New England Tel. Co.* v. *United States*, No. 3:94-CV-80 (DJS) (D. Conn. Apr. 27, 1995), appeal pending, No. 95-6137 (2d Cir.); *Southwestern Bell Co.* v. *United States*, No. 3:94-CV-0193-D (N.D. Tex. Mar. 27, 1995), appeal pending, No. 95-10478 (5th Cir.); *GTE South, Inc.* v. *United States*, No. CA-94-1588-A (E.D. Va.

overturn those unanimous rulings. *Amici* therefore have a substantial interest in this Court's resolution of this case.

INTRODUCTION AND SUMMARY OF ARGUMENT

A. Telecommunications services were formerly divided along technological lines. Telephone companies offered voice and data communications services, while cable companies offered transmission of video programming. Although telephone companies today are willing and able to provide cable service, 47 U.S.C. § 533(b) prevents them from competing with incumbent cable operators.

This Court recognized the distortions caused by the monopoly position of cable operators when it reviewed the 1992 Cable Act in *Turner Broadcasting Sys.* v. *FCC*, 114 S. Ct. 2445, 2454-2466 (1994). Petitioners now attempt to preserve the status quo in that market and continue to protect the cable industry from competition. *E.g.*, Gov't Br. 3; NCTA Br. 3.[4]

But the monopolistic system is giving way to technological, economic, and regulatory changes affecting telephone and cable service. Technology now makes possible the convergence of previously distinct services, providing opportunities for competition where none existed before. Consumers expect new services that combine the abilities of previously distinct industries. At the same

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Feb 10, 1995), appeal pending, No. 95-1738 (4th Cir.); *United States Tel. Ass'n* v. *United States*, No. 1:94CV01961 (D.D.C. Feb. 14, 1995), appeal pending, No. 95-5117 (D.C. Cir.); *NYNEX Corp.* v. *United States*, No. 93-1523-P-C (D. Me. Dec. 8, 1994), appeal pending, No. 95-1183 (1st Cir.); *BellSouth Corp.* v. *United States*, 868 F. Supp. 1335 (N.D. Ala. 1994), appeal pending, No. 94-7036 (11th Cir.); *Ameritech Corp.* v. *United States*, 867 F. Supp. 721 (N.D. Ill. 1994), appeal pending, No. 95-1223 (7th Cir.).

[4] "Gov't Br." refers to the Brief for the Federal Petitioners. "NCTA Br." refers to the Brief for Petitioner National Cable Television Association, Inc. "Pet. App." refers to the opinions of the courts below, reprinted in the Appendix to the government's Petition for Writ of Certiorari in No. 94-1893. "J.A." refers to the Joint Appendix in the consolidated cases before this Court. "Ct. App. J.A." refers to the joint appendix before the court of appeals.

time, regulators have developed far more sophisticated methods of identifying and preventing anticompetitive abuses by regulated entities.

Section 533(b) prevents the natural development of technological solutions to the problems of cable monopoly. As a consequence, the statute limits the number of cable television operators and harms fundamental First Amendment principles encouraging more speech and greater diversity among speakers.

B. This Court should, at a minimum, apply intermediate scrutiny to determine the constitutionality of Section 533(b). The government bears a substantial burden under that standard: it must show that the regulation actually furthers a substantial government interest and that it is narrowly tailored (*i.e.*, that it does not burden more speech than is necessary to achieve the government's purpose). Congress made no findings or predictive judgments in 1984 (when it enacted Section 533(b)) or later; nor did it consider less restrictive alternatives. Instead, it simply codified the Federal Communications Commission's (FCC's) existing regulatory ban. Thus, there is no basis for this Court to defer to Congress concerning the statute's justification. Even imputing to Congress the reasons given by the FCC for its prior regulatory restriction, this Court should strike down the statute because those reasons no longer pertain, as the FCC itself has found.

The statute cannot survive intermediate scrutiny. Petitioners argue that Congress might have imposed a ban on video speech out of concern that regulatory measures would be inadequate to prevent telephone companies from engaging in anticompetitive behavior (discrimination or cross-subsidization) in the cable market. But the government petitioners themselves have repeatedly found (and argued in judicial and regulatory proceedings) that there is no real risk of such anticompetitive behavior. Those official government findings are confirmed by court decisions and regulatory developments: there is simply no need for a ban on speech. Section 533(b) cannot be justified as protecting or enhancing competition in the cable market. That market is currently dominated by monopolists, and telephone companies are the most promising sources of real competition. Section 533(b) actually inhibits competition and diversity.

Section 533(b)'s complete ban is not narrowly tailored to serve any government interest. There is nothing unique about video programming that justifies imposing a total prohibition in order to prevent cross-subsidization and discrimination. The speculative risk of such anticompetitive behavior would be equally present in any line of business telephone companies might enter, but Section 533(b) imposes a ban only on cable television service. The FCC has developed a comprehensive regulatory scheme to prevent the very kind of anticompetitive behavior petitioners purport to fear. The Justice Department and the FCC have repeatedly expressed confidence in those measures. The government does not assert that those safeguards are inadequate to protect ratepayers or competitors.

ARGUMENT

I. SECTION 533(b) IS SUBJECT, AT A MINIMUM, TO INTERMEDIATE SCRUTINY

Amici agree with Bell Atlantic that Section 533(b) is subject to strict scrutiny under the First Amendment for the reasons set forth in respondents' brief. Nevertheless, we do not address those issues here because — as every court that has addressed this issue has found — the statute cannot survive even intermediate scrutiny. *A fortiori*, it would not survive strict scrutiny either.

A. Petitioners Bear a Rigorous Burden of Demonstrating that the Statute is Constitutional

The government and NCTA bear the burden of demonstrating that Section 533(b) is consistent with the First Amendment under the intermediate scrutiny standard. *Rubin* v. *Coors Brewing Co.*, 115 S. Ct. 1585, 1591-1592 (1995); *Turner*, 114 S. Ct. at 2470. That standard requires petitioners to demonstrate that the speech restriction actually "promotes a substantial government interest" and that it is narrowly tailored, so that the means chosen do not "burden substantially more speech than is necessary to further the government's legitimate interests." *Ward* v. *Rock Against Racism*, 491 U.S. 781, 799 (1989); see also *Turner*, 114 S. Ct. at 2469; *United States* v. *O'Brien*, 391 U.S. 367, 377 (1968).[5]

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[5] In addition to these elements, a restriction on speech must also "leave

In *Turner*, the plurality applied the intermediate scrutiny standard and rejected many of the contentions petitioners make here.[6] The Court emphasized the substantiality of the government's burden in a case such as this:

- *First*, the government must identify the important "governmental interest" that the statute is designed to serve. *Turner*, 114 S. Ct. at 2470. It is not enough to identify an "abstract" interest. *Ibid.*

- *Second*, the government must demonstrate that the speech restriction *actually* furthers the identified interest. When the speech restriction is purportedly justified "as a means to redress past harms or prevent anticipated harms," the government "must demonstrate that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way." *Ibid.*

- *Third*, even if the restriction does further an important interest by remedying a real harm, it still must be narrowly tailored. "[T]he Government still bears the burden of showing that the remedy it has adopted does not burden substantially more speech than is necessary to further the government's legitimate

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open ample alternative channels for communication." *Ward*, 491 U.S. at 791 (quoting *Clark* v. *Community for Creative Non-Violence*, 468 U.S. 288, 293 (1984)). The government acknowledges that the statute must meet this standard to survive intermediate scrutiny. Gov't Br. 24 (quoting *Ward*). The Fourth Circuit correctly found Section 533(b) unconstitutional on this independent ground. Pet. App. 49a. We agree with Bell Atlantic that petitioners' arguments on this point are unavailing, and we do not address the issue separately.

[6] The section of the *Turner* opinion discussed here, 114 S. Ct. at 2470-2472, was joined by four members of the Court. Three others would have struck down the restriction outright, without need for further factfinding. *See id.* at 2479-2480 (O'Connor, J., concurring in part and dissenting in part) (finding must-carry rules unconstitutionally overbroad because not narrowly tailored). Justice Stevens, who dissented from the plurality's "application of [the] standard," did not disagree with the principles announced. *See id.* at 2473 n.1 (Stevens, J., concurring in part and concurring in the judgment).

interests." *Ibid.* (internal citations omitted); see also *id.* at 2479 (O'Connor, J., concurring in part and dissenting in part) ("Assuming arguendo that the provisions are justified with reference to the content-neutral interests in fair competition and preservation of free television, they nonetheless restrict too much speech that does not implicate those interests").

B. Deference to Congress is Not Appropriate Here

Petitioners ostensibly concede that intermediate scrutiny is the correct standard by which to determine Section 533(b)'s constitutionality. But they proceed to water down the requirements of that standard, contending that their mere assertion of a hypothetical "reasonable" basis for the law should justify a ban on speech. See, *e.g.*, Gov't Br. 29, 31-33, 35; NCTA Br. 41. Indeed, although the government urges the Court to defer, it suggests deference to a litigating position rather than to any legislative finding. Gov't Br. 29 ("the question for the courts is whether the regulation of speech is reasonably necessary to advance any significant interest of the government, not whether the enacting Congress expressly found it to be necessary").

Petitioners hypothesize various purposes that Section 533(b) might serve — but they cannot seriously maintain *either* that Congress made factual findings or empirical predictions embodying those speculations *or* that those speculations are supported by the weight of actual evidence. Instead, they urge this Court to impute to Congress the litigators' speculations, and then to defer to those speculations without proof that "the recited harms are real," or that Section 533(b) will "alleviate these harms in a direct and material way," or that the statute does not "burden substantially more speech than necessary." *Turner*, 114 S. Ct. at 2470, (internal quotations and ellipsis omitted). This would reduce intermediate scrutiny to mere "reasonableness" review, in defiance of this Court's many cases emphasizing the importance of rigorous testing of speech restrictions.

Turner suggests that there are two approaches the government might take to meet its substantial burden of justifying a statute such as Section 533(b). If Congress has made express findings of fact amounting to "predictive judgments," the government must "assure" the Court, in its "exercise [of] independent judgment," that "Con-

gress has drawn reasonable inferences based on substantial evidence." *Turner*, 114 S. Ct. at 2471.[7] However, where — as here — Congress has made no such findings, the government must shoulder the more onerous burden of "defending the factual necessity" for a restriction on speech by putting forward real evidence of actual facts supporting the need for the statute in light of the interests it is designed to support. *Ibid.* This petitioners have not done and cannot do, given the government's repeated conclusions that the statute is not necessary.

Rather than "defending the factual necessity" for Section 533(b), petitioners seek to uphold the statute based on theories that Congress demonstrably did not itself consider. See, *e.g.*, Gov't Br. 31, 35; NCTA Br. 40, 42-43. Some could not have been conceived in 1984.[8] For example, the possibility of "discrimination" against competitive video providers seeking access to the telephone network could not have been part of Congress' consideration of the statute in 1984 because no one imagined then that cable companies would be dependent on the local telephone network to transmit video programming to consumers. Indeed, they are *not* dependent on the telephone network. Similarly, there is no evidence that Congress or anyone else thought that the Pole Attachments Act (47 U.S.C. § 224) had failed to achieve its purpose. Nor did Congress reject

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[7] Even this standard is an exacting one: the Court vacated the lower court's judgment in *Turner*, requiring "the Government [to] further demonstrate" that the harms Congress feared would actually come about in the absence of the statute. 114 S. Ct. at 2472. This demonstration could take the form of "a more substantial elaboration * * * of the predictive or historical evidence upon which Congress relied, or the introduction of some additional evidence to establish that" the risk is real. *Ibid.* The government had ample opportunity here to present its best evidence; its own findings, however, preclude any showing that the risk is real.

[8] We agree with the government (Gov't Br. 29 n.19) that a statute may be justified by evidence and arguments that were not presented to, or not available to, Congress when it enacted the law. Instead of attempting to meet their burden of proving such a justification by offering real evidence of the need for the statute, petitioners grasp for unwarranted deference to a Congress that did not consider, and could not have considered, the justifications now presented to the Court.

the possibility of regulatory alternatives to a complete ban: the FCC had not yet developed its cost accounting and affiliate transaction rules, and Congress made no inquiry as to whether such rules could have solved the problem.

Petitioners appear to concede that Congress made no findings or predictive judgments in 1984 when it enacted Section 533(b). Their deference argument depends heavily on Congressional hearings and committee reports, as well as General Accounting Office (GAO) reports, dating from well *after* 1984. See, *e.g.*, Gov't Br. 33-34; NCTA Br. 16-17, 42. Congress' failure to repeal the statute in later years, however, cannot support petitioners' demand for deference. "[S]everal equally tenable inferences may be drawn from [congressional] inaction." *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 114 S. Ct. 1439, 1453 (1994) (internal quotation marks omitted). "[F]ailed legislative proposals are a particularly dangerous ground on which to rest an interpretation of a prior statute." *Ibid.* (internal quotation marks omitted); see also *PBGC* v. *LTV Corp.*, 496 U.S. 633, 650 (1990). In *Central Bank* and other cases, this Court has rejected the argument that such materials can illuminate even the *meaning* of a statute passed earlier. Here petitioners would ascribe even more significance to the inaction of a later Congress, suggesting that a Committee report or hearing testimony from seven years after a statute's passage can substitute for the contemporaneous findings that might have motivated earlier legislators to support the original speech restriction.[9]

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[9] Even if this argument had any merit, none of the cited materials amounts to a finding or predictive judgment. First, the government quotes a 1991 report of the Senate Commerce Committee as concluding that "cross-ownership restrictions like Section 533(b) 'enhance competition.'" Gov't Br. 10-11 (quoting S. Rep. No. 92, 102d Cong., 1st Sess. 46-47 (1991) (*1991 Senate Report*)); see also NCTA Br. 17. The government omits to mention that the quotation referred not primarily to Section 533(b), but to a wide array of cross-ownership restrictions (arguably supported by justifications of spectrum scarcity). It cannot be deemed a determination of the success of Section 533(b). The government also quotes an earlier report as "concluding that [the committee] should not at the present time support repeal." S. Rep. No. 456, 101st Cong., 2d Sess. 4-8 (1990), quoted in Gov't Br. 34. That report, however, was studiously

Of course, we agree that "Congress is not obligated, when enacting its statutes, to make a record of the type that an administrative agency or court does to accommodate judicial review." *Turner*, 114 S. Ct. at 2471, quoted in Gov't Br. at 29. But the government's invocation of that familiar principle is a non sequitur. We do not fault Congress for the absence of findings when it enacted the statute in 1984; we merely point out that the bare fact that Congress enacted a speech restriction does not bring into play the deference this Court reserves for express findings and actual predictive judgments. Nor do we contend that a finding must be included as a separate section within the body of a law passed by Congress (as in the 1992 Cable Act, reviewed in *Turner*). But here there is no evidence of *any* actual consideration; petitioners can point only to evidence of *later* debates on *different* bills that did not pass.

Indeed, deference is even less appropriate here than in *Sable Communications* v. *FCC*, 492 U.S. 115 (1989), where this Court rejected a similar argument by the government. In *Sable*, the government contended that the mere fact that a statute was enacted amounted to a congressional judgment that there was no less restrictive alternative to the complete ban at issue in that case. *Id.* at 129. In addition to emphasizing the impropriety of judicial deference in the face of a First Amendment claim, the Court also noted that there were no legislative findings to support the government's argument. "[A]side from conclusory statements during the debates by proponents of the bill, as well as similar assertions in hearings on a substantially identical bill the year before, * * * the congressional record presented to us contains no evidence as to *how* effective or ineffective the FCC's most recent regulations were or might prove to be." *Id.* at 129-130.

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neutral in its summary of conflicting opinion on the utility of the video programming ban (S. Rep. No. 456, at 4), and instructed the FCC to complete a study of Section 533(b). *Id.* at 8-9; see also *1991 Senate Report* at 18 (confirming that 1990 report did not determine underlying issues). The FCC did so the next year, when it recommended repeal. *Telephone Company-Cable Television Cross-Ownership Rules* (Second Report and Order), 7 FCC Rcd 5849, 5781, 5847 (1988) (*Video Dialtone Order*).

Even if this Court determined that Congress' silence could be deemed an implicit adoption of the justifications given 14 years earlier by the FCC when it imposed the regulatory ban on video programming, those justifications cannot support the statute now. As we show (pp. 19-20, *infra*), the FCC originally relied solely on concerns relating to pole attachments, which Congress specifically addressed in the 1978 Pole Attachments Act. The FCC's 1981 conclusion that the risk of cross-subsidy might justify retaining the ban was based solely on the absence of a comprehensive scheme to allocate shared costs between regulated and competitive ventures. Since then, the agency has developed just such a comprehensive scheme, which it has repeatedly identified as sufficient to control the potential for anticompetitive behavior. Thus, even if Congress once deferred to the FCC's regulatory justifications, there is no basis for judicial deference today — when the FCC itself has determined that those justifications are no longer present.

Petitioners seek to invoke uncritical deference for a reason: they are unable to support their pretextual justifications for Section 533(b) with any real evidence. As we show below, their asserted fears of anticompetitive behavior are all without foundation.

II. SECTION 533(b) CANNOT WITHSTAND INTERMEDIATE SCRUTINY

In *Turner*, this Court held that the government had not proffered sufficient evidence to support judgment in its favor.[10] The government's case here is far weaker than it was in *Turner*. Here, Congress made no findings of fact, either in 1984 or at any subse-

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[10] In *Turner*, the government had not itself moved for summary judgment below, but the district court granted judgment to the government based on its submissions in opposition to the plaintiffs' motion. See 114 S. Ct. at 155. Because the government had not had an opportunity to submit factual material in support of its position, the Court remanded for further proceedings. Here, by contrast, the government did move for summary judgment and did submit factual and other materials. As the district court noted, the parties presented "a comprehensive stipulation of facts and a supporting record consisting of several thousand pages of affidavits, exhibits, and briefs." Pet. App. 57a. There is, accordingly, no basis for a remand. This Court should affirm.

quent time, that the video programming ban is necessary to serve important governmental interests. Pet. App. 45a-46a & n.32. Here, "the two federal agencies responsible for formulating executive branch policy on telecommunications and antitrust matters agree that § 533(b) *does not* promote competition and diversity in cable television, and * * * may actually hinder the achievement of those objectives." *Ameritech*, 867 F. Supp. at 736; see also Pet. App. 96a (the ban "clearly operates in the first instance to restrict competition in the market for video programming"); J.A. 337-347 (excerpts from official agency positions concerning the effect of Section 533(b)). And here, the statute in question has clearly failed to achieve its avowed purpose of promoting competition and diversity: although the video programming ban has been in effect for 25 years, Congress itself has acknowledged that "[t]he cable industry has become highly concentrated." Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460, § 2(a)(4) (1992 Cable Act); see also J.A. 173, 174-178 (aff. of Thomas W. Hazlett). Under these circumstances, the video programming ban in Section 533(b) fails to satisfy the requirements of intermediate scrutiny. It is significant that, in spite of the best efforts of the government and the cable industry, every federal court to address the question, including the Fourth Circuit and the Ninth Circuit, has struck down Section 533(b).

A. Petitioners Have Identified No Substantial Governmental Interest Actually Advanced by the Statute

The government and NCTA rely on the Fourth Circuit's statement that the government's interests in preventing anticompetitive behavior (thereby enhancing competition) and promoting diversity in cable television are substantial. Gov't Br. 24 (citing Pet. App. 38a-39a); NCTA Br. 36; see also Pet. App. 17a-18a. The government even quotes *Turner*'s statement that "eliminating restraints on fair competition" and assuring "access to a multiplicity of information sources" are "substantial" interests. 114 S. Ct. at 2470, quoted in Gov't Br. 24. Nowhere, however, do petitioners themselves describe the particular interests that Section 533(b) is purportedly designed to serve. *See Edenfield v. Fane*, 113 S. Ct. 1792, 1798 (1993) (looking to "the precise interests put forward by the [government]").

The government's quotation from *Turner* conveniently omits the sentence immediately following: "That the Government's asserted interests are important in the abstract does not mean * * * that the must-carry rules will in fact advance those interests." *Turner*, 114 S. Ct. at 2470; see also *Edenfield*, 113 S. Ct. at 1800. To satisfy intermediate scrutiny, abstract importance is not enough: the government must do more than just identify a purported concern; it must "demonstrate that the recited harms are real, not merely conjectural." *Turner*, 114 S. Ct. at 2470.

Petitioners' briefs show once again the importance of the analysis in *Turner*. The government and NCTA ask this Court to uphold Section 533(b) based solely on the "abstract" importance of the interests they assert. In fact, even the "abstract" interests of ensuring fair competition and diversity in the cable market are directly disserved by Section 533(b). As the Fourth Circuit noted, the statute "appears to inhibit competition and undermine diversity by effectively keeping the telephone companies * * * out of the cable business, thereby allowing cable companies to keep their monopolies." Pet. App. 17a-18a; see also *U S West*, 48 F.3d at 1102. To the extent that the larger government interest is promoting competition and diversity in the cable market, Section 533(b) is obviously counterproductive. See pp. 20-21, *infra*.

1. *There is no substantial risk of cross-subsidization or discrimination.*

It is revealing that the government never suggests that it actually believes that the ban is necessary to prevent anticompetitive behavior or to promote diversity. Instead, the government contends merely that some regulators have in the past used cross-ownership restrictions "to curtail the potential for abuse of market power and to encourage diversity in holdings." Gov't Br. 25 & n.15. The government does not contend that the statutes it cites would have survived the intermediate scrutiny that Section 533(b) must satisfy. The statutes there were either based on this Court's cases allowing greater restrictions on broadcast media (see *Turner*, 114 S. Ct. at 2456-2457) or they did not directly prohibit protected speech.

The twin fears raised by petitioners are "abstract," meritless, and completely preventive. They do not take account of market

realities or the substantial legal and regulatory safeguards already in place.

Cross-subsidization would require a local telephone company — in addition to violating strict rules by misallocating costs common to telephone service and cable service and raising telephone rates to recover the difference — to charge inflated rates to telephone customers and predatorily low rates to cable customers, all the while avoiding detection by state and federal regulators, competitors, and ratepayers. Presumably, the telephone company's primary competitor, the incumbent cable operator, would not go quietly from its privileged position in the face of actual anticompetitive behavior.

Petitioners' discrimination claim is equally unrealistic. They hint that a telephone company might deny the incumbent cable operator access to poles and conduits. Gov't Br. 35; NCTA Br. 8 & n.5. The FCC referred to this issue when it adopted the regulatory predecessor to Section 533(b) in 1970, but Congress later adopted a statutory remedy (the 1978 Pole Attachments Act), 47 U.S.C. § 224. Petitioners do not seriously contend that the Pole Attachments Act is so inadequate and beyond repair that a ban on speech is required to accomplish its aims. See Pet. App. 42a (quoting *id.* at 102a n.29). Moreover, the government has found that cable operators already have access to virtually every home in America. *Telephone Company-Cable Television Cross-Ownership Rules* (Further Notice of Inquiry and Notice of Proposed Rule-making), 3 FCC Rcd 5849, 5854 (1988) ("[n]ecessary access to poles and conduit to permit the growth of the cable industry has generally occurred"). The prospect of discrimination at this stage is simply fanciful.

Petitioners also suggest, without explanation or elaboration, that telephone companies could somehow discriminate against cable operators by controlling access to the telephone network. See Gov't Br. 36-37. This is simply absurd: cable operators have their own separate networks to transmit video programming to subscribers; they do not depend on the telephone network at all.[11] The existing

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[11] NCTA's complaints about the (unrealistic) prospect of discrimination is ironic. Its own members have violated laws designed to limit discrimination by cable operators. See, *e.g.*, *Turner*, 114 S. Ct. at 2454-2455.

cable networks provide an alternative to the telephone network and therefore a competitive check on the possibility of discrimination, and they would not be affected by any discrimination that the telephone companies might attempt. In the unlikely event that an existing cable operator goes out of business when faced with competition, its network will remain in place, offering a ready asset to a potential competitor that wants to challenge the telephone company.[12] Consequently, any resulting dominant market position would be contestable by other entrants. The existing cable industry, by contrast, is sheltered from competitive pressures by Section 533(b).

Petitioners' speculation about cross-subsidization and discrimination ignores a fundamental fact: incumbent cable operators dominate the market, reaching 98% of television households with their extensive network. See Gov't Br. 17-18 (citing hypothetical risk that telephone companies will drive out incumbent cable operators and "exten[d] their telephone monopoly to the cable market"). Telephone companies would be new entrants, trying to compete with established monopolist firms. Petitioners' purported concerns assume that the new entrant will drive the incumbent monopolist entirely out of the market by violating stringent legal and regulatory restrictions and evading regulatory and competitive monitors. Achieving this end would be practically, as well as legally, suspicious, and would require (unrealistically) that the new entrant be able to hide a pattern of substantial predatory pricing that is so successful it not only allows the entrant to obtain market share but completely reverses the relative roles of the two primary rivals. See, *e.g.*, *Matsushita Elec. Co.* v. *Zenith Radio Corp.*, 475 U.S. 574, 589 (1986).

The FCC's comprehensive regulatory measures are designed specifically to prevent discrimination and cross-subsidization by telephone companies. These rules can be relied on to prevent the speculative ills hypothesized by petitioners. Indeed, the government petitioners themselves — both the FCC and the Department of Justice — have repeatedly and emphatically expressed confidence that

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[12] NCTA acknowledges that the existing cable network may even compete with the telephone network for voice and data carriage, or for access to long-distance carriers. NCTA Br. 9.

the existing rules are sufficient to monitor and prevent anticompetitive practices (see pp. 26-27, *infra*). Congress has made no contrary judgment and petitioners have not shown that these safeguards are such abject failures that a ban on speech is required.

In short, there is no reason to believe that telephone companies could cross-subsidize or discriminate without detection, much less that they could do so to such an extent that they would inflict any competitive injury.

2. Historical materials do not support petitioners' argument.

The government and NCTA allege that various historical experiences justify the ban in Section 533(b). For example, they contend that the 1982 consent decree settling the government's antitrust case against AT&T and the FCC's 1970 regulatory ban on telephone company video programming (the predecessor to Section 533(b)) can somehow be understood to support the statutory ban on speech. Those assertions are misleading in their descriptions of events and omit later developments that directly refute petitioners' arguments.

a. The Information Services decision confirms that Section 533(b) serves no purpose.

Petitioners point to the consent decree that divested the Bell telephone companies from AT&T, suggesting that the 1982 settlement of a complex government antitrust case against AT&T justifies today's ban on telephone companies seeking to offer cable television. Gov't Br. at 25 & n.16; NCTA Br. 10-12. This argument distorts the record. In fact, the history of the consent decree since divestiture demonstrates conclusively that the government's assumptions and fears in *this* case — which petitioners assert are equivalent to those underlying the consent decree — are not borne out by experience.

The AT&T divestiture decree entered in 1982 prohibited the Bell telephone companies from providing "information services." *United States* v. *AT&T*, 552 F. Supp. 131, 227-229 (D.D.C. 1982), aff'd *sub nom. Maryland* v. *United States*, 460 U.S. 1001 (1983).[13]

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[13] Only the Bell telephone companies (those owned by *amici* Ameritech, NYNEX, Pacific Telesis, SBC Communications, *amici* U S West and

That prohibition included video programming.[14] Thus, at the time Section 533(b) was enacted, the Bell companies were already prohibited from offering video programming.[15]

The information services prohibition was not based on any evidence that AT&T or the Bell telephone companies had ever engaged in anticompetitive behavior in that context: "The parties agreed to the information services restriction as a precautionary measure * * * ." *United States* v. *Western Elec. Co.*, 900 F.2d 283, 307 (D.C. Cir. 1990) (*Triennial Review*), *cert. denied*, 498 U.S. 911 (1990). The 1982 decree settled government antitrust allegations "centered exclusively on AT&T's activities in the interexchange-service [long-distance] and equipment-manufacturing markets." *Ibid.* "[T]here really was no record to speak of concerning AT&T's activities in the information services market" or in any other non-

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BellSouth, and respondent Bell Atlantic) are covered by the decree. *Amicus* GTE is subject to a different decree. *United States* v. *GTE Corp.*, 603 F. Supp. 730 (D.D.C. 1984). The remaining telephone company *amici* (more than 1300 companies) have never been subject to the restrictions in either consent decree. Petitioners do not distinguish between these groups of telephone companies, simply assuming that the rationale of the decree applies with equal justification to all those subject to Section 533(b). There is no basis for such an assumption and it demonstrates again the poor fit of Section 533(b) to purported regulatory needs.

[14] See Reply Memorandum of FCC As Amicus Curiae, *United States* v. *Western Electric Co.*, C.A. No. 82-0192, at 6 n.10 (D.D.C. filed Jan. 18, 1991) (*FCC Reply Brief*) (Ct. App. J.A. 2671, 2684 n.10). The category of information services includes any service that involves generating, acquiring, packaging, or manipulating information that can be transmitted over a telecommunications network. *AT&T*, 552 F. Supp. at 229; see also *United States* v. *Western Electric Co.*, 673 F. Supp. 525, 589-590 (D.D.C. 1987) (listing examples).

[15] Because the restriction was the result of a voluntary settlement, it was not subject to First Amendment challenge. Thus, it is not surprising that telephone companies "did not oppose" Section 533(b) when Congress considered the proposal. See NCTA Br. 15. The minimal legislative history demonstrates that even Congress paid little attention to the specifics of Section 533(b). See *Id.* at 13 (legislative history is "not elaborate").

telecommunications market because the company had long been prohibited from entering those markets in a 1956 consent decree. *Ibid.* (citing *United States* v. *Western Elec. Co.*, 1956 Trade Cas. ¶ 68,246, at 71,138 (D.N.J. 1956)).

Since then, the decree parties (including the Department of Justice) and the courts have recognized that the hypothetical fears underlying this "precaution[ ]" were insubstantial and that continued exclusion of the Bell companies from providing information services (such as video programming) is unwarranted. Accordingly, the courts have lifted the information services restriction based largely on *the government's own representations* that there was no continuing need for it.

In 1987, three years after divestiture had been completed, the Justice Department conducted a full-scale review of the decree, including an "in-depth research" report by an independent consultant hired by the government. *Triennial Review*, 900 F.2d at 291. As a result of that review, and "[a]fter studying the comments of the parties and intervenors on its recommendations, the [Department] formally moved the court * * * for the removal of all the line of business restrictions," including information services. *Id.* at 292.[16] The Department was not alone: "With respect to the non-telecommunications and information services restrictions, all of the parties to the original decree — AT&T, the [Bell companies], and the [Department] — as well as the FCC agreed that the restrictions should be removed." *Ibid.*

The decree court at first declined to remove the information services ban entirely, prompting appeals by the Justice Department as well as the Bell companies. The D.C. Circuit held that the decree court should not have retained the information services restriction in the face of the government's (and every other party's) view that the restriction was not necessary to serve the public interest. *Id.* at 307-309. On appeal after remand, the D.C. Circuit affirmed the removal of the information services restriction. The court of appeals reviewed the substantial evidence before the district

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[16] The Department recommended that the decree court leave intact the prohibition on local telephone companies offering certain long-distance ("interexchange") service.

court (much of it proffered by the Justice Department) that the information services ban was *not* necessary and was in fact anti-competitive. *United States* v. *Western Elec. Co.*, 993 F.2d 1572, 1578-1582 (D.C. Cir.) (*Information Services*), cert. denied, 114 S. Ct. 487 (1993). Significantly, those who then opposed the view of the telephone companies and the Justice Department raised the same specters that petitioners now point to: discrimination and cross-subsidization. *Ibid.* The *Information Services* court rejected those illusory fears. This Court should take notice that the government in that case not only recognized the insubstantiality of those concerns, but actually demonstrated to the court's satisfaction that discrimination and cross-subsidization were *not* real risks. See *id.* at 1580.[17]

The arguments raised here to support Section 533(b) are the same tired claims that were presented to, and repeatedly rejected by, the government and the courts in the information services context. For example, NCTA opposed the government's proposal to lift the information services restriction, arguing that it would give the Bell companies "unparalleled opportunities for cross-subsidization of and discrimination against cable operators." Br. of NCTA, *United States* v. *Western Elec. Co.*, at 15 (D.D.C. filed Oct. 17, 1990). It is telling that, since the information services restriction was lifted in October 1991, there has been no evidence of anticompetitive abuse by telephone companies offering information services. Petitioners' purported concerns here are even weaker because cable companies do not depend on access to telephone company facilities to deliver video programming to consumers.

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[17] In addition to petitioners' misleading arguments based on the consent decree and the FCC's 1970 regulation, *amicus* California Cable Television Association (CCTA) alleges that a California telephone company has committed various misdeeds. CCTA Br. 13-16. These allegations are based on one-sided presentations of routine regulatory disputes. Contrary to CCTA's implication, neither the FCC, the California Public Utility Commission, nor any other independent reviewer has ever found that Pacific has engaged in cross-subsidization or discrimination.

b. The FCC's 1970 regulatory ban does not demonstrate a risk of anticompetitive behavior.

NCTA notes the development of the FCC's 1970 regulation prohibiting telephone companies from owning or operating cable television systems, which Congress codified in Section 533(b). NCTA Br. 5-6; see *Applications of Tel. Cos.*, 21 F.C.C. 2d 307, 324 (1970). One reason for imposing the ban in 1970 was to shelter a new and undeveloped cable television business from the full rigors of competition. *Video Dialtone Order*, 7 FCC Rcd at 5848 ("the ban gave cable television operators an opportunity to firmly establish themselves as viable competitors"); see also *Applications of Tel. Cos.*, 21 F.C.C. 2d at 314, 324-325. By 1992, however, the FCC recognized that there had been "enormous growth [in] the cable industry," which now holds "a leading position in the delivery and provision of video programming to the American public." *Video Dialtone Order*, 7 FCC Rcd at 5848; see also *Ameritech*, 867 F. Supp. at 727. In fact, Congress has found that the cable industry's unchallenged growth has had severe anticompetitive results. "The cable industry has become highly concentrated" and wields "undue market power," resulting in "barriers to entry for new programmers and a reduction in the number of media voices available to consumers." 1992 Cable Act §§ 2(a)(2), 2(a)(4). The government's purpose for restricting telephone company speech in 1970 — giving a fledgling industry a chance to develop — cannot support Section 533(b) today, when the statute protects a monopolistic media behemoth from the most promising source of competition.

When it adopted its regulatory ban in 1970, the FCC feared that telephone companies might use their control over telephone pole and conduit access to prevent competing cable companies from establishing networks to deliver video programming. *Applications of Tel. Cos.*, 21 F.C.C. 2d at 324. In 1978, Congress addressed that concern directly by authorizing the FCC to "regulate the rates, terms, and conditions for pole attachment." 47 U.S.C. § 224(b)(1); see also 47 C.F.R. § 1.1401 (implementing regulations).

Because the pole attachment statute largely eliminated the concern underlying the regulatory ban, a 1981 FCC staff report focused on a concern that the FCC expressly declined to rely on in 1970: the risk of anticompetitive cost-shifting, or cross-subsidization. J.A.

54-58; see also Pet. App. 94a (noting change from 1970 order to 1981 report). The 1981 report concluded that the ban should be retained until the FCC could develop regulations segregating the costs of a telephone company's regulated operations from the costs incurred in non-regulated, competitive businesses. *Id.* at 158, 175. The FCC has since developed and fully implemented just such a comprehensive cost allocation scheme (see pp. 24-26, *infra*).

Thus, since the regulatory ban was adopted, there have been significant changes in the regulatory, competitive, and technological environment. As a result, the FCC — to which Congress deferred in the first place — *now* has concluded that the reasons for banning telephone companies from the cable television business are no longer valid. See, *e.g.*, *Video Dialtone Order*, 7 FCC Rcd at 5848-5849.

3. Section 533(b) is demonstrably anticompetitive.

Although petitioners seek to justify Section 533(b) on the ground that it prevents anticompetitive behavior (*e.g.*, Gov't Br. 17; NCTA Br. 36-37), the irony of their position is that the statute itself is blatantly anticompetitive. Its primary effect is to block a sophisticated and able competitor — the local telephone company — from entering a market that would benefit from competition. In the statute's absence, telephone companies would provide an infusion of much-needed competition in the cable market. It is simply counterproductive to exclude the only real competitor under the guise of promoting competition. "Freedom of entry is the single most important guarantor of competition in a concentrated industry." *United States* v. *FCC*, 652 F.2d 72, 106 (D.C. Cir. 1980) (en banc).

The video programming ban has been in place (in statutory or regulatory form) for some 25 years.[18] In the real world and after

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[18] The government suggests that Congress requires "a reasonable opportunity to experiment with solutions to admittedly serious problems." Gov't Br. 28-29 (quoting *City of Renton* v. *Playtime Theatres, Inc.*, 475 U.S. 41, 52 (1986)). Section 533(b) is not a new, "experiment[al]" rule. The statute must stand or fall based on the application of intermediate scrutiny *today*, not on whether Congress needed a reasonable opportunity to experiment in 1984. See also Gov't Br. 29 n.19.

a fair test, Section 533(b) has not promoted competition and diversity in cable television. To the contrary, Congress concluded in 1992 that "most cable television subscribers have no opportunity to select between competing cable systems," and that the "cable industry has become highly concentrated." 1992 Cable Act §§ 2(a)(2), 2(a)(4). In light of this indisputable fact, it is preposterous to contend that Section 533(b) promotes competition and diversity "in a direct and material way." *Turner*, 114 S. Ct. at 2470. The ban also subverts the purported goal of diversity in information sources by cutting off the expression of a whole category of speakers. See *Coors*, 115 S. Ct. at 1592 (holding that a labeling ban did not "directly and materially advance [the government's] asserted interest because of the overall irrationality of the Government's regulatory scheme").

None of this is mere speculation. The government agencies with regulatory and oversight responsibilities for the telephone and cable industries — petitioners FCC and the Justice Department, as well as the National Telecommunications and Information Administration (NTIA) — have *expressly found* that the ban should be removed because it impedes competition and limits diversity. J.A. 337-347. These formal, factual investigations and reports are within the scope of the agencies' regulatory jurisdiction, and this Court is entitled to rely on them — and not the position put forward by government litigators — concerning the state of the market and other facts relevant to the constitutional analysis.

4. Petitioners have not met their burden of showing that Section 533(b) actually advances a substantial government interest.

The requirement that a speech restriction actually advance the identified interests is critical to constitutional analysis under the intermediate scrutiny standard. *Turner*, *Coors*, and *Edenfield* are only the most recent examples of cases where the Court has focused on this element. Petitioners' briefs make little attempt to demonstrate that there is a real purpose behind Section 533(b) in today's world. Their identified concerns are based on outdated and inaccurate allegations, which cannot justify restricting telephone company speech today, especially in the absence of real competition in the cable market. Moreover, they are directly contradicted by official government findings.

B. Section 533(b) is Not Narrowly Tailored

The requirement of narrow tailoring should be rigorously applied, as this Court's decisions demonstrate. In recent years, the Court has struck down a number of restrictions because they failed the narrow tailoring requirement, many for the very same reasons that Section 533(b) fails this standard.

Thus, the Court rejected a blanket ban on in-person solicitation by accountants where the state's justification applied equally to solicitation by mail or advertisement. *Edenfield*, 113 S. Ct. at 1801; see also *City of Cincinnati* v. *Discovery Network, Inc.*, 113 S. Ct. 1505, 1516 (1993) (striking down a restriction on newsracks because it distinguished without reason between commercial and noncommercial publications). Here, Section 533(b) singles out cable programming, while the government's justifications apply just as well (or as badly) to all information services and even all competitive (nonregulated) businesses.

Just last Term, the Court held unconstitutional a federal law prohibiting disclosure of alcohol content on beer labels and advertisements. *Coors*, 115 S. Ct. at 1592 (noting the "overall irrationality of the Government's regulatory scheme," allowing alcohol content disclosure in many advertisements but not on labels). Here, telephone company regulators have recognized that telephone companies have significant new services and products to offer consumers, who will benefit from increased competition. Regulators have replaced blanket restrictions with comprehensive and sophisticated oversight of financial activities.

Also last Term, the Court held that a prohibition on all executive branch employees from receiving honoraria was not narrowly tailored to the government's asserted interest in employee efficiency. *United States* v. *National Treasury Employees Union*, 115 S. Ct. 1003, 1015 (1995) (noting the significant burden on the public's right to read and hear what the employees would write and say and that the vast majority of speech subject to the ban has no effect on the government's interests); see also *id.* at 1016-1017 (identifying aspects of the ban that "cast serious doubt on" the government's identified justifications). Here, prohibiting telephone companies from providing cable service denies the public the benefits of in-

creased diversity and competition in the currently monopolized cable market.

The government could not prohibit the distribution of newspapers for the purpose of eliminating traffic injuries and deaths caused by newspaper delivery trucks — even if eliminating such injuries is a compelling interest and even if regulatory measures aimed directly at traffic safety were less effective. For the same reason, the government cannot forbid telephone companies from providing video programming out of a fear that they might cross-subsidize or discriminate. The risk of such behavior is inherent in any business venture undertaken by a rate-of-return regulated enterprise, and there has been no showing that regulatory alternatives are in fact inadequate.

1. Petitioners' justifications for Section 533(b) are not unique to video programming.

It is significant that the justifications raised by petitioners are not unique to the expressive activity of offering video programming.[19] In theory, telephone companies would be able to engage in cross-subsidization and discrimination whenever they enter *any* line of business other than regulated telephone service. Regulators and lawmakers have long recognized, however, that there is no justification for a total ban on such enterprises as publishing telephone directories, monitoring alarm systems, or providing information such as news and weather. See *Information Services*, 993 F.2d at 1578. Petitioners have identified nothing about the video programming business that suggests the dangers are greater here than elsewhere, but cable is the *only* expressive business that telephone companies are banned from entering. We believe it is also significant that cable is a business that the Court has recognized deserves constitutional protection. Since a rate-regulated company could (in

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[19] In fact, as the lower courts found, the government's justifications have nothing to do with video programming at all. Any risk of cross-subsidization could arise only from joint costs between telephony and video *transport*, which is permitted by Section 533(b). There simply are no joint costs between telephony and video *programming*. Pet. App. 42a-43a; *id.* at 102a ("§ 533(b) is irrelevant to the telephone companies' ability to undertake such practices"); see also *U S West*, 48 F.3d at 1102, 1104.

theory) cross-subsidize any other line of business it enters, the government must point to some *unique* reason (something more than the mere possibility of cross-subsidy) for singling out a medium of protected *speech* for this sweeping prohibition.

Section 533(b)'s poor "fit" is no different than a hypothetical statute prohibiting electric utility companies from owning and publishing a newspaper. Such a ban could be justified on concerns of cross-subsidization and discrimination against competitors (newspapers who need electric power). In fact, this Court has struck down less drastic attempts to regulate the speech of utility companies. In the most recent case, the Court noted that the speech at issue, a newsletter included in billing envelopes, was "[i]n appearance no different than a small newspaper." *Pacific Gas & Elec. Co.* v. *Public Utility Comm'n*, 475 U.S. 1, 8 (1986) (plurality); see also *id.* at 19 (noting absence of narrow tailoring); *Central Hudson Gas & Elec. Corp.* v. *Public Serv. Comm'n*, 447 U.S. 557, 570 (1980).

2. Existing regulatory safeguards protect against cross-subsidization and discrimination.

Turner emphasizes that the government must demonstrate (and a reviewing court must determine) that there are no "availab[le] and efficac[ious] constitutionally acceptable less restrictive means of achieving the Government's asserted [objectives]." 114 S. Ct. at 2472 (internal quotation marks omitted). Here, petitioners dispute the propriety of the Fourth Circuit's holding that such less speech-restrictive alternatives *are* available to address the government's purported interests. Gov't Br. 27; NCTA Br. 40-41. We agree with Bell Atlantic's analysis of the flaws in that position. But petitioners do not address the narrower ground that supports the lower courts' judgment striking down the statute: that *existing* regulatory measures already address and prevent the potential for cross-subsidization and discrimination.

a. FCC regulations prohibit and prevent anticompetitive behavior.

The regulatory regime prohibiting cross-subsidization has changed drastically since 1984, when Section 533(b) was enacted. First, the FCC has replaced rate-of-return regulation with price caps and average schedule rates, a regulatory system that removes any

incentive to cross-subsidize. *See Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786 (1990), recon., 6 FCC Rcd 2637 (1991) (price-cap regulations); 47 C.F.R. § 69.606 (average schedule regulations);[20] see also *National Rural Telecom Ass'n* v. *FCC*, 988 F.2d 174, 178 (D.C. Cir. 1993) (under the price-cap system, there is no "reward for shifting costs from unregulated activities into regulated ones, for the higher costs will not produce higher legal ceiling prices"); *Information Services*, 993 F.2d at 1580 (price-cap regulation "reduces * * * ability to shift costs from unregulated to regulated activities"); *People of California* v. *FCC*, 39 F.3d 919, 926 (9th Cir. 1994) (a telephone company "would have little incentive to shift costs from nonregulated activities to regulated ones because it would not be able to increase regulated rates to recapture those costs"), cert. denied, 115 S. Ct. 1427 (1995).[21]

Second, the FCC has adopted detailed cost accounting rules designed to allocate costs carefully between regulated and nonregulated services. See, *e.g.*, *Separation of Costs*, 2 FCC Rcd 1298 (*Joint Cost Order*), recon., 2 FCC Rcd 6283 (1987), further recon., 3 FCC Rcd 6701 (1988), aff'd *sub nom. Southwestern Bell Corp.* v. *FCC*, 896 F.2d 1378 (D.C. Cir. 1990); *Bell Operating Co. Safeguards and Tier 1 Local Exchange Co. Safeguards*, 6 FCC Rcd 7571, 7594 (1991) (*BOC Safeguards*). These rules did not exist in 1984, when Congress enacted Section 533(b), and the FCC's 1981 Staff Report specifically identified the absence of such a regulatory

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[20] The average schedule rules establish a system by which over 600 telephone companies, nearly half of those subject to the ban in Section 533(b), set prices according to a schedule based on the total costs incurred by all participating companies. Use of this formula (like the price-cap regime) reduces the incentive and ability of telephone companies to cross-subsidize because interstate rates for these companies are not directly tied to their individual company costs.

[21] NCTA contends that the FCC's (and many states') move to price-cap regulation is meaningless unless it is "pure price cap regulation, severing all connection to costs." NCTA Br. 37 n.31 (internal quotation marks omitted). But there is no support for that proposition. Even where the regulator retains some residual authority to account for costs, there is no significant potential for cross-subsidy.

regime as a justification for retaining the ban at that time. J.A. 58. Thus, the only justification that can even indirectly be attributed to Congress — the absence of regulatory means to control the risk of cross-subsidization — is simply no longer true.

The FCC's *Joint Cost* rules (1) impose detailed cost allocation standards, (2) establish accounting procedures, audit requirements, and other implementation and enforcement mechanisms, and (3) set rules for recording transactions between regulated telephone companies and their corporate affiliates. See *People of California*, 39 F.3d at 926. Under the cost allocation standards, telephone companies are required, in apportioning costs between regulated and nonregulated services, to (a) charge the nonregulated activity for tariffed services at the tariffed rates (and apply an equivalent credit to the regulated service providing the tariffed services); (b) directly assign all costs, whenever possible, to either regulated or nonregulated activities; and (c) group unassignable "common" costs into certain categories and allocate them according to a specific methodology. *Joint Cost Order*, 2 FCC Rcd at 1318. In addition, all common investment costs relating to "central office equipment and outside plant" must be allocated "based upon the relative regulated and nonregulated usage of the investment at the highest forecast relative nonregulated usage over the life of the investment." *Id.* at 1319 (emphasis added). In this way, the *Joint Cost* rules impose a systematic bias in favor of the customers of the regulated activity (thereby preventing cross-subsidization and counteracting it to the extent it goes undetected) by ensuring that joint costs are to some extent shifted automatically to the nonregulated activity from the regulated — not vice versa.

b. The government has repeatedly and formally found that existing regulatory safeguards are effective.

The FCC and the Justice Department have both emphatically found that the existing regulatory safeguards are adequate to protect ratepayers and competitors. In its most recent pronouncement on the subject, the FCC has found "that our current regulatory safeguards against cross-subsidy are sufficient to protect telephone ratepayers when a telephone company provides cable service over [ ] a stand-alone cable system." *In Re: Telephone Company-Cable Television Cross-Ownership Rules* (Fourth Report and Order), FCC

95-357, at 9, ¶ 18 (rel. Aug. 14, 1995) (*Fourth Report*). The FCC specifically identified price cap rules, affiliate transaction requirements, and the cost allocation rules in the *Joint Cost Order*. See *id.* at 9-10 & nn. 43-45. Significantly, the *Fourth Report* did not even address fears of discrimination, implicitly acknowledging the unreality of that concern where telephone companies offer traditional cable television service. See *id.* at 9 (identifying as "a primary concern * * * [only] that telephone ratepayers not bear the burden of the investment in [cable] systems").

The *Fourth Report* is just the most recent of many FCC affirmations that its regulatory safeguards protect ratepayers and prevent anticompetitive behavior, including cross-subsidization and discrimination. See also, *e.g.*, *Video Dialtone Order*, 7 FCC Rcd at 5827 ("existing safeguards against discrimination and cross-subsidization" suffice to "protect against potential anticompetitive conduct"). The Justice Department has also approved these safeguards, expressing its view that FCC regulations suffice to protect ratepayers from cross-subsidization and protect competitors from discrimination. For example, both the FCC and the Justice Department made the same admission — that regulatory safeguards are sufficient to address the problems of cross-subsidization and network discrimination — in the *Information Services* litigation (see pp. 17-18, *supra*). *Information Services*, 993 F.2d at 1580.[22] See also *Ameritech*, 867 F. Supp. at 734-35 ("The FCC and DOJ have taken the position that * * * concerns about cross-subsidization and network discrimination could be addressed by federal regulations. * * * In this litigation, the Government states that 'the defendant agencies stand by their assessment.'")

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[22] See Memorandum of United States in Support of Motions for Removal of the Information Services Restriction, *United States* v. *Western Electric Co.*, C.A. No. 82-0192, at 15-33 (D.D.C. filed Aug. 22, 1990) (Ct. App. J.A. 2631-2649); Reply Memorandum of United States in Support of Motions for Removal of the Information Services Restriction, *United States* v. *Western Electric Co.*, C.A. No. 82-0192, at 6, 60-65 (D.D.C. filed Jan. 18, 1991) (Ct. App. J.A. 2790-2795); *FCC Reply Brief* at 25 (Ct. App. J.A. 2703).

We do not mean to suggest — as petitioners might characterize our argument (Gov't Br. 32 n.21) — that the views of executive and independent agencies should trump a legislative determination. Rather, these government pronouncements are important precisely because there has been no legislative determination here (thus, there is no occasion for deference to Congress, see pp. 6-10, *supra*). Intermediate scrutiny requires careful justification of a speech restriction by demonstrating its *actual* effects. *Turner*, 114 S. Ct. at 2470. Petitioners simply have not shown that, in the real world, there is any deficiency in the existing regulatory safeguards requiring a complete ban on speech. All the available evidence — and all of petitioners' statements in other fora — demonstrate the opposite: that the existing safeguards do an excellent job of monitoring and preventing anticompetitive abuses.

c. Petitioners have not shown that regulatory safeguards are inadequate.

Petitioners have no real evidence of regulatory failure. They point to two GAO reports, hinting that the GAO determined that cross-subsidization is not redressable by regulatory measures. Gov't Br. 31, 33. In fact, the reports criticize only the insufficient staffing at the FCC; notably, they recognize in principle the efficacy of the *Joint Cost* rules as a means of controlling cross-subsidies. *E.g.*, J.A. 83, 124. Indeed, the Court should view the government's arguments here with substantial skepticism; they are flatly contradicted by repeated public pronouncements of the FCC and the Justice Department. See *Video Dialtone Order*, 7 FCC Rcd at 5828 ("while some parties contend that the FCC lacks the resources to adequately protect against anticompetitive conduct, we note that we have previously concluded that this contention is without merit") (footnote omitted).[23] As we have shown (pp. 8-9 & note 9, *supra*), the

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[23] Even if this Court were to seriously entertain an argument that petitioner FCC has elsewhere conceded "is without merit," the argument must be rejected. Surely hiring a few more auditors is a less restrictive means of accomplishing the government's objectives than silencing the video programming speech of the telephone companies. If Congress and the Administration do not consider the regulatory objective important enough to warrant additional audit staff, the government should not be

various post-1984 committee reports and snippets of hearing testimony simply do not support the view that Congress or any other government entity actually believed that the FCC's regulatory measures are inadequate.

C. Petitioners Have Not Met Their Burden Under Intermediate Scrutiny

Economic regulation not affecting speech is subject to deferential review when challenged in court. If Congress wishes to exclude one class of competitors to preserve the position of another, the Constitution does not stand as a bar, so long as litigators defending the law can suggest a reasonable basis for the restriction. But, as this Court recently reaffirmed in *Turner*, Congress has no such latitude when it restricts protected speech.

Where, as here, the government bars willing speakers from an entire medium of communications that is now dominated by monopolists, and explains its ban with the assertion that the restriction promotes competition, it bears a heavy burden of justification. This is a burden that petitioners do not meet — indeed, they have scarcely even attempted to meet it. For the government petitioners to demonstrate that Section 533(b) actually *advances* the objectives of competition and diversity would require them to contradict the conclusions of every study of the issue they have undertaken in the past eight years. Their only hope is to persuade this Court to avert its eyes from the actual regulatory record and reverse the unanimous judgments of federal courts in ten different cases on the basis of hypothetical, unproven, and implausible theories that were *never* adopted (or even considered) by Congress, that were *repudiated* by petitioners themselves, and that were concocted solely for the purpose of this litigation. The First Amendment demands more.

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heard to claim that the objective is important enough to satisfy heightened scrutiny under the First Amendment.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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Petitioners,

—v.—

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF VIRGINIA, *et al.*,

Respondents.

NATIONAL CABLE TELEVISION ASSOCIATION, INC.,

Petitioner,

—v.—

BELL ATLANTIC CORPORATION, *et al.*,

Respondents.

ON WRITS OF *CERTIORARI* TO THE
UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF *AMICUS CURIAE* OF THE AMERICAN CIVIL LIBERTIES UNION AND THE ACLU OF VIRGINIA IN SUPPORT OF RESPONDENTS

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INTEREST OF *AMICI* [1]

The American Civil Liberties Union (ACLU) is a nationwide, nonprofit, nonpartisan organization with nearly 300,000 members dedicated to the principles of liberty and equality embodied in the Constitution. In support of those principles, the ACLU has appeared before this Court on numerous occasions, both as direct counsel and as *amicus curiae*. The ACLU of Virginia is its statewide affiliate.

Throughout its seventy-five year history, the ACLU has been particularly concerned about the relationship between government regulation and free speech, and has insisted that government efforts to regulate speech be rigorously justified. Recently, for example, the ACLU filed an *amicus* brief in *Turner Broadcasting System, Inc. v. FCC*, 512 U.S. __, 114 S.Ct. 2445 (1994), urging the development of a fuller factual record -- a position that this Court ultimately adopted. In this case, the government once again seeks to regulate speech in the name of diversity. Because these issues are of direct concern to the ACLU and its members, we respectfully submit this brief to assist the Court in resolving the important questions presented.

STATEMENT OF THE CASE

This is an appeal from a decision of the United States Court of Appeals for the Fourth Circuit declaring that 47 U.S.C. §533(b) violates the First Amendment. *Chesapeake & Potomac Telephone Company v. United States*, 42 F.3d 181 (4th Cir. 1994). Section 533(b), which was enacted in 1984 as part of Congress' comprehensive regulation of the cable industry, forbids a local telephone company (referred

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[1] Letters of consent to the filing of this brief have been lodged with the Clerk of the Court pursuant to Rule 37.3.

to in the government's papers as an LEC) from directly providing video programming to viewers in its local community either through its own telephone wires or over a cable system owned, operated, or controlled by the telephone company.[2]

According to the government, Congress feared that if a local telephone company were permitted to provide video programming in its local service area, it would be in a position to use its monopoly over local telephone service to unfairly subsidize its video operations by improperly allocating video costs to telephone operations. In addition, Congress apparently feared that if local telephone companies were permitted to enter the video market as full-fledged competitors, they would be tempted to sabotage the signals of competitors who had no choice but to transmit over telephone company property.

Section 533(b) had its genesis in a 1970 FCC study made during the infancy of the cable industry and a decade before the breakup of the Bell system, warning that the vulnerable new CATV industry might be stifled if local telephone companies were permitted to offer the same service.[3] *See* 21 F.C.C.2d 307 (1970). In 1984, Congress enacted §533(b), adopting the 1970 FCC rules, apparently without considering whether the emergence of cable as a powerful

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[2] The operative language of the statute forbids a local telephone company from "provid[ing] video programming directly to subscribers in its telephone service area." 47 U.S.C. §533(b)(1).

[3] The 1970 regulations were reaffirmed by a 1980 FCC staff study released on the eve of the breakup of the Bell system. *FCC Policy on Cable Ownership: A Staff Report* 141-178. Significantly, every FCC study since the breakup of the Bell system has recommended abolishing the speech restrictions on local telephone companies at issue in this case.

industry, or the breakup of the Bell monopoly, had so changed the circumstances that censorship of the local telephone companies was unwarranted.[4] Three years later, the FCC renewed its study of the issue and concluded, in a series of reports from 1987 to 1994, that the existing censorship regime was no longer justified. *See* 2 F.C.C. Rcd. 5092 (1987); 3 F.C.C. Rcd. 5849 (1988); 7 F.C.C. Rcd. 300 (1991); 7 F.C.C. Rcd. 5781 (1992), *modified in part on reconsideration*, 10 F.C.C. Rcd. 244 (1994). Despite the prodding of the FCC, however, Congress declined to repeal §533(b).[5]

Confronted by a statute whose underlying rationale had been expressly disavowed by the relevant administrative agency, respondents sued on First Amendment grounds. In response, the district court invalidated §533(b) as underinclusive because it permitted a local telephone company to offer its lines to transmit the speech of third persons, creating the same danger of anticompetitive behavior against competitors who do not sign up with the phone company but must use its facilities. 830 F.Supp. 909.

The Fourth Circuit affirmed, holding that the risks perceived by Congress did not justify a flat ban on speech. Specifically, the court ruled that a flat ban was not a nar-

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[4] Since Congress made no effort to make factual findings explaining its action, the most reasonable assumption is that it was based on the 1970 FCC study.

[5] The closest Congress came to providing an explanation for its refusal to repeal §533(b) was a 1990 Senate Report describing concerns about the "potential" for anticompetitive practices and the need for media diversity. S. Rep.No. 456, 101st Cong., 2d Sess. 9 (1990). How "media diversity" is advanced by barring telephone companies from competing with existing cablecasters and over-the-air broadcasters was not explained.

rowly tailored way of dealing with Congress' legitimate regulatory concerns and that permitting local telephone companies to produce programs for transmission on someone else's facilities was not a constitutionally adequate alternative. 42 F.3d 181.

On May 16, 1995, the FCC sought to repeal §533(b) unilaterally by announcing that it would use its waiver powers to permit a local telephone company to offer video service in its local community, as long as a significant cable competitor existed. *F.C.C. Third Report and Order* (May 16, 1995).[6] While the FCC's newly minted reading of the Act may ameliorate the effect of §533(b), it hardly solves the constitutional problem. First, the new waivers are wholly discretionary. Second, they come with a number of strings. Third, they do not permit a telephone company to purchase an existing cable system. Fourth, and most importantly, the FCC's controversial current reading of the statute's waiver provision is subject to change with every shift in personnel. No long-term plans can be made in reliance upon such a thin reed.

INTRODUCTORY STATEMENT AND SUMMARY OF ARGUMENT

Despite the close link between speech and amplifying technology, the precise legal relationship between the two concepts has always presented difficult constitutional issues. At times, this Court has uncoupled technological amplification from speech, permitting regulation of amplification technology despite an adverse impact on the speaker. *E.g.*,

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[6] Ironically, the FCC's order permits local telephone companies to offer video programming only in those settings where the danger of anticompetitive conduct exists.

Red Lion Broadcasting Co. v. FCC, 395 U.S. 367 (1969); *CBS, Inc. v. FCC*, 453 U.S. 367 (1981); *Ward v. Rock Against Racism*, 491 U.S. 781 (1989); *Kovacs v. Cooper*, 336 U.S. 77 (1949). At other times, the Court has merged the two concepts, treating the effort to regulate amplification technology as though it were an effort to censor speech itself. *E.g., Saia v. New York*, 334 U.S. 558 (1948); *CBS, Inc. v. Democratic Nat'l Committee*, 412 U.S. 94 (1973); *Miami Herald Publishing Co. v. Tornillo*, 418 U.S. 241 (1974); *Pacific Gas & Electric Co v. Public Utilities Comm'n*, 475 U.S. 1 (1986). *See generally* Ithiel de Sola Pool, TECHNOLOGIES OF FREEDOM (1983).

This appeal provides the Court with an opportunity to continue the process, begun in *Turner Broadcasting System, Inc. v. FCC*, 114 S.Ct. 2445 (1994), of clarifying the differing constitutional norms governing efforts to regulate speech and amplifying technology. In *Turner Broadcasting*, this Court considered the constitutionality of a congressional statute requiring cablecasters to transmit the signals of over-the-air broadcasters in an effort to protect broadcasters against possible "gatekeeper" abuse. Since the precise First Amendment impact of the statute on cablecasters was unclear, especially in settings where unused channel capacity existed, and since the trial court had failed to subject the government's factual justification for the so-called "must carry" rules to appropriately rigorous scrutiny, the *Turner Broadcasting* Court remanded the case for additional proceedings.

Under *Turner Broadcasting*, when government directly regulates the act of speech, either by imposing content-based restrictions or by directly impinging on the speech function, the statute must satisfy classic First Amendment scrutiny, including a factual showing that the regulation is necessary to advance a compelling state interest. When, however, government regulates amplifying technology in a manner that

does not unduly impinge upon the speech function, the statute must satisfy an intermediate level of scrutiny requiring a significant, but somewhat less demanding, factual justification.

Applying the *Turner Broadcasting* principles to the speech ban at issue in this case, we believe that the refusal to permit local telephone companies to function as vertically integrated speakers in their local communities is a direct regulation of speech triggering classic First Amendment strict scrutiny. But, it is equally important to note that the justifications offered by the government for §533(b) -- the risk of cross-subsidization and discriminatory behavior -- cannot satisfy any form of heightened First Amendment scrutiny because they are premised on speculation and conjecture. Far more than guesswork is required before the government may flatly forbid a speaker from using its own property to communicate with willing hearers. *City of Ladue v. Gilleo*, 512 U.S. __, 114 S.Ct. 2038 (1994). Moreover, Congress has made no effort to explain why the feared evils underlying the speech ban could not be forestalled by far less onerous alternatives. *Rubin v. Coors Brewing Co.*, 514 U.S. __, 115 S.Ct. 1585 (1995); *Sable Communications, Inc. v. FCC*, 492 U.S. 115 (1989).

Permitting local telephone companies to function as full-fledged speakers is, however, only the beginning of this case. The scope and extent of permissible -- perhaps required -- government regulation of a telephone company's monopoly control over significant amplification technology must also be explored. In that regard, we believe that the need for "gatekeeper" regulation of the amplification technology at issue in this case is at least as powerful as in *Turner Broadcasting*, and may well call for a significant level of regulation designed to assure fair access to the technology by competing speakers.

ARGUMENT

BANNING LOCAL TELEPHONE COMPANIES FROM USING THEIR OWN PROPERTY TO AMPLIFY THEIR SPEECH VIOLATES THE FIRST AMENDMENT

A. The Relationship Between Speech And Amplifying Technology

In the era before Gutenberg, little attention was paid to the intersection of speech, law and technology, because primitive technology and mass illiteracy radically constrained a speaker's potential audience. With the invention of printing[7] and the emergence of vernacular language, efforts to control speech predictably centered on the new technology. Not surprisingly, the first great free speech document in the English language -- Milton's AREOPAGETICA (1644)[8] -- was a plea for unlicensed printing,[9] and the first great event in the American free speech tradition -- the 1735 acquittal of John Peter Zenger[10] -- arose out of the prosecution of a printer.

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[7] Gutenberg invented movable type in about 1450 in the city of Mainz. Louis Dudek, LITERATURE AND THE PRESS: A HISTORY OF PRINTING, PRINTED MEDIA AND THEIR RELATIONSHIP TO LITERATURE 14 (1960).

[8] John Milton, COMPLETE POEMS AND MAJOR PROSE 716 (Merritt Y. Hughes ed. 1957).

[9] Licensing of printing presses was initially imposed in London in 1530. It was abandoned in 1694. *See* Frederick S. Siebert, FREEDOM OF THE PRESS IN ENGLAND, 1476-1776, at 46. *See also* Leonard W. Levy, EMERGENCE OF A FREE PRESS (1985); Jeffrey A. Smith, PRINTERS AND PRESS FREEDOM (1988).

[10] The *Zenger* trial is reported at 17 How. St. Tr. 675 (1735). James Alexander was the author of the words for which Zenger was tried. *See* Eben Moglen, "Considering Zenger: Partisan Politics and the Legal Profession in Provincial New York," 94 Colum.L.Rev. 1495 (1994).

In Zenger's day, as in Milton's, the speaker and the printer were separate entities. It was not until the invention of the rotary press in the 19th century that the speech and amplification functions were united in a single powerful speaker operating as an integrated economic unit -- the mass newspaper.[11] In the early 20th century, moreover, the perfection of three revolutionary amplifying technologies -- telephone, moving pictures, and broadcast -- raised fundamental questions about control of the new technology. In each setting, we were obliged to choose whether to continue the Zenger model (in which the speech and amplification functions are carried out by separate entities), or to adopt the mass newspaper model (in which both the speaker and amplification functions are merged in a vertically integrated economic unit).

In the motion picture context, we used vigorous enforcement of the anti-trust laws to prevent the emergence of a single motion picture entity with control over both production and amplification technology.[12] In the context of the telephone and telegraph, Congress opted even more con-

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[11] For a survey of the evolution of print technology, *see* Jonathan W. Emord, FREEDOM, TECHNOLOGY AND THE FIRST AMENDMENT (1991); and Colin Clair, THE HISTORY OF PRINTING IN BRITAIN 205-29 (1966).

[12] While motion picture producers were not wholly banned from owning theaters, they were precluded from controlling the distribution of their motion pictures to a mass audience. *See* Dana E. Roof, *et al.*, "Structural Regulation of Cable Television: A Formula for Diversity," 15 Comm. & L. 43, 59-65 (1993), for a survey of the enforcement of anti-trust law in the motion picture context. The critical early decision forced Thomas Edison to dissolve his Motion Pictures Patent Company because it gave him unfair control of the emerging technology. *See also United States v. Paramount Pictures, Inc.*, 1940-43 Trade Cas. (CCH) 288 (S.D. N.Y. 1940); *United States v. Paramount Pictures, Inc.*, 66 F.Supp. 323 (S.D.N.Y. 1946), 70 F.Supp. 53 (S.D.N.Y. 1947), *aff'd in part and rev'd in part*, 334 U.S. 131 (1948).

clusively for the Zenger model, explicitly awarding monopoly control over amplification technology to the Bell system in return for a commitment to perform solely as a conduit, not a speaker.[13]

In the broadcast area, however, drawn by the success of newspapers as organs of mass communication, Congress encouraged the merger of the speaker and amplification functions in a single powerful economic entity -- the broadcaster. *National Broadcasting Co. v. United States*, 319 U.S. 190 (1943)(refusing to permit local broadcast licensees to function solely as conduits for networks).[14]

Most recently, amplification technology has centered on the use of wires -- cable and telephone -- as a method of delivering speech to the home. The FCC initially viewed cable transmission as merely a means of clarifying the broadcast signal. *FCC v. Midwest Video Corp.*, 440 U.S. 689; *United States v. Midwest Video Corp.*, 406 U.S. 649 (1972); *United States v. Southwestern Cable Co.*, 392 U.S. 157 (1968). Over time, however, cable broadcasters have been recognized as fully integrated speakers, with control over both the speaker function and the amplifying technology. *City of Los Angeles v. Preferred Communications, Inc.*, 476 U.S. 488 (1986); *Turner Broadcasting System, Inc. v. FCC*, 114 S.Ct. 2445.

By contrast, local telephone companies have been fro-

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[13] *See* Commerce Court (Mann-Elkins) Act, ch. 309, §7, 36 Stat. 539 (1910). The rise and fall of the Bell system is chronicled in Michael K. Kellogg, *et al.*, FEDERAL COMMUNICATIONS LAW 5-48 (1992). *See also* Robert W. Garnett, THE TELEPHONE ENTERPRISE: THE EVOLUTION OF THE BELL SYSTEM'S HORIZONTAL STRUCTURE, 1876-1909 (1985).

[14] *E.g.*, Radio Act of 1927, §18 (currently codified as §315 of the Communications Act of 1934)(current version at 47 U.S.C. §315 (1988). *See FCC v. Midwest Video Corp.*, 440 U.S. 689, 703-04 (1979).

zen by law into the Zenger model. 47 U.S.C. §533(b). Under existing law, local telephone companies may function either as a speaker using someone else's amplification technology, or as an amplifier transmitting someone else's speech, but may not act as a vertically integrated speaker in their own communities. The precise question raised by this case, therefore, is whether government may require a would-be speaker to adopt the Zenger model of separate ownership and control of the speech and amplification functions.

B. The Power To Regulate Amplification Technology

As we gained experience in the 20th century with both the Zenger model and the vertically integrated model, we learned, first, that a government mandated separation of the speech and amplification functions in the form of a trade-off of monopoly control over amplification technology in return for a promise to act as a common carrier for the speech of others, can lead to technological stagnation and monopoly abuse. Accordingly, we dismantled the Bell system. *United States v. American Tel. & Tel. Co.*, 524 F.Supp. 1336 (D.D.C. 1981); *United States v. American Tel. & Tel. Co.*, 552 F.Supp. 131 (D.D.C. 1982), *aff'd mem. sub nom. Maryland v. United States*, 460 U.S. 1001 (1983). *See* Temin, THE FALL OF THE BELL SYSTEM (1987).

We also learned that powerful, vertically integrated speakers exercising control over significant amplification technology pose a threat to a robust free market in ideas in two ways. First, a vertically integrated speaker in control of a crucial amplification technology can become so powerful that it drowns out other voices. Second, a vertically integrated speaker may abuse its "gatekeeper" control over amplification technology by denying access to competing voices, or otherwise engaging in unfair competition. Accordingly, this Court has recognized that a vertically inte-

grated speaker may be subject to regulation to assure fair use of its amplification technology -- but may not be subject to direct regulation of the speaker function.

For example, newspapers, the original vertically integrated speakers, are subject to rigorous anti-trust regulations designed to prevent a single newspaper from exercising undue control over amplifying technology, but are free from virtually all efforts to regulate content. Compare *Citizen Publishing Co. v. United States*, 394 U.S. 131 (1969); *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951); *Associated Press v. United States*, 326 U.S. 1 (1945), with *Miami Herald Publishing Co. v. Tornillo*, 418 U.S. 241, and *Hustler Magazine v. Falwell*, 485 U.S. 46 (1988). Similarly, broadcasters, as vertically integrated speakers, are subject to anti-trust, cross-ownership, size and coverage regulations designed to assure fair access to the inherently scarce broadcast technology, without unduly burdening the broadcaster's speech function. *National Broadcasting Co. v. United States*, 319 U.S. 190; *Red Lion Broadcasting Co. v. United States*, 395 U.S. 367; *FCC v. National Citizens Comm. for Broadcasting*, 436 U.S. 775 (1978). Finally, in recent years, cablecasters have been subject to regulation of their "gatekeeper" power over access to cable technology, while remaining free to function as unregulated speakers. *Turner Broadcasting System v. FCC*, 114 S.Ct. 2445.

The principal issue posed by this case is whether local telephone companies may be forbidden from joining newspapers, broadcasters and cablecasters as vertically integrated speakers.[15] In support of Congress' refusal to permit local

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[15] In one sense, therefore, this case is the obverse of *National Broadcasting Co. v. United States*, 319 U.S. 190, in which local broadcasters sought to function solely as conduits for the speech of network speakers. The Court ruled that the FCC was empowered to force local broadcast-

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telephone companies to function as vertically integrated speakers, the United States argues that local telephone companies may be banned from functioning as both a speaker and an amplifier because they exercise monopoly control over the amplification technology over which much of the speech in question would flow. However, the mere existence of substantial control over amplification technology cannot itself be a basis for flatly refusing to permit an entity from functioning as both an amplifier and a speaker. Rather, it may justify, in appropriate circumstances, regulation designed to assure that other speakers enjoy fair access to the amplification technology.

It is, of course, true that local telephone companies exercise monopoly control over their local network of wires. As a practical matter, however, each category of vertically integrated speaker exercises substantial control over their respective amplification technologies. Cablecasters exercise a natural monopoly over local cable systems resulting in a single cablecaster serving the vast bulk of American homes.[16]

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[15] (...continued)
ers to exercise independent editorial discretion over network shows, thus compelling them to function as both speakers and amplifiers.

Here, Congress refuses to permit local telephone companies to function as both speakers and amplifiers. There is, of course, a world of constitutional difference between a regulation compelling a speaker to exercise editorial responsibility and a regulation forbidding a speaker from doing so.

[16] Although federal law prohibits the grant of formal monopolies to cable systems, fewer than one percent of existing cable systems face competition from a competing system. "Must Carry: Hearing Before the Subcommittee on Communications of the Senate Committee on Commerce, Science and Transportation," 101st Cong., 1st Sess. 40 (1989). *See Preferred Communications, Inc. v. City of Los Angeles*, 754 F.2d 1396 (9th Cir. 1985), *aff'd on narrower grounds*, 476 U.S. 488 (1986).

Broadcasters exercise government-granted exclusive control over a finite number of wavelengths. *Turner Broadcasting*, 114 S.Ct. at 2457. Even newspapers, once intensely competitive, increasingly operate as local monopolies.

The United States contends, however, that the formal monopoly exercised by local telephone companies over amplification technology poses a heightened risk of abuse at three levels. First, the United States argues, the complex ratemaking process for local monopoly telephone service provides a fertile opportunity to cross-subsidize the telephone company's speaker functions by allocating speech costs unfairly to the telephone system. The net result of such an unfair allocation would be higher telephone rates and artificially low operating costs for the speaker function. Moreover, the government argues, to the extent the same wires are involved in both monopoly telephone service and speech transmission, the potential for accounting improprieties is significantly magnified.

Second, the United States argues, to the extent that other speakers must use the telephone company's system, either to transmit on its wires or to use its poles to string separate wires, permitting the telephone company to become a competing, vertically integrated speaker creates a potent motive to sabotage the transmissions of competitors.

Finally, although not explicitly pressed by the government, permitting a local telephone company to become a vertically integrated speaker risks the emergence of an extremely powerful speaker with so much influence over content that the free market in ideas may suffer in a given community. Presumably, that is why the waiver rules recently promulgated by the FCC in an effort to save the statute ap-

ply only in settings where a competing cablecaster is present.[17]

While the concerns over cross-subsidization and sabotage articulated by the government are serious and may well justify, if not compel, significant regulation of a telephone company's amplification technology, none of the government's arguments justify a flat refusal to permit a local telephone company to function as a vertically integrated speaker. Congress has failed utterly to demonstrate that the feared evils are even probable (let alone likely), as opposed to merely possible; and has failed utterly to explain why careful regulation of the amplification technology is not an adequate response to the risk of inappropriate behavior.

C. Speech May Not Be Banned On The Basis Of Assertions That Speech Has A "Bad Tendency" To Lead To Improper Behavior

The parties are in fundamental disagreement over the appropriate standard of review in this case. The United States argues that §533(b), as either a cross-ownership rule or a content-neutral regulation of technology, is subject to a relaxed form of intermediate scrutiny that requires the government to prove merely that it was reasonable for Congress to fear that telephone companies might behave improperly if permitted to act as vertically integrated speakers. Thus, the government argues that, at most, a relaxed form of intermediate scrutiny requires a showing that "the economic and predictive judgments underlying section 533(b) are reasonable."

The telephone companies, on the other hand, argue that §533(b), as a flat ban on speech, should be subjected to

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[17] *FCC Third Report and Order* (May 16, 1995).

strict scrutiny, requiring the government to prove, first, that telephone companies are almost certain to engage in improper conduct and, second, that no less drastic means exists to cope with the potential for misconduct.

Amici believe that §533(b) is a direct regulation of speech triggering classic strict First Amendment scrutiny. Unlike the regulation at issue in *Turner Broadcasting*,[18] §533(b) is openly designed to preclude a defined category of speaker from using its own property to amplify its speech. If Congress were to ban left-handed people -- or rich people -- from using their property to amplify their speech, the government would be obliged to submit its factual justification to withering judicial scrutiny. *Buckley v. Valeo*, 424 U.S. 1 (1976). Section 533(b) bans telephone companies, not left-handed people, from using their property to permit their speech to reach willing listeners. While the government's reasons for regulating telephone companies are, no doubt, stronger than its reasons for regulating left-handed people, the strict standard of constitutional review is the same. In both settings, the government is directly interfering with the desire of an identifiable category of speaker to use its property to transmit speech to a willing audience. If such a direct interference with speech is to be permitted, it must be because the government has proven (not merely asserted) an overwhelming social need.

It is, however, unnecessary to decide whether §533(b) should be subjected to strict scrutiny, or to the somewhat less rigorous intermediate scrutiny utilized in *Turner Broadcasting*, because the government's wholly speculative justifi-

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[18] The must carry rule at issue in *Turner Broadcasting* was designed to protect a category of speakers by assuring speaker access to an important amplification technology. Unlike §533(b), the must carry rule was not designed prevent cablecasters from functioning as vertically integrated speakers.

cations for the speech ban fail to satisfy any level of scrutiny associated with modern First Amendment protection. Although couched in the terminology of intermediate scrutiny, the reality of the government's position is to ask this Court to uphold §533(b) because it was reasonable for Congress to have feared that permitting local telephone companies to speak freely over their telephone wires might lead to attempts at cross-subsidization or sabotage.[19]

While such a prophylactic approach to the risk of future harm may be appropriate in other settings, the very essence of modern First Amendment protection precludes the government from banning speech as a prophylactic response to a speculative future evil. Since the government has made

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[19] Significantly, the Clinton Administration has taken a very different position in other forums. For example, in a White Paper on Communication Act Reforms, the Administration stated:

> Although the existing cable-telephone company cross ownership restriction of the 1984 Cable Act may have been appropriate when enacted, today it is an unnecessary and artificial barrier to competition in the delivery of video programming to American consumers and to investment in local infrastructure. The Administration's proposal to remove the current restriction, coupled with its proposals to promote competition in local telephone service, will allow telephone companies and cable operations to compete in providing a full range of video, voice and data services to the public. Such competition can promote investment that expands consumer choices and services.

The Justice Department's Antitrust Division has also reached the conclusion that §533(b) is no longer necessary as a check on the anticompetitive practices of local telephone companies. *Chesapeake & Potomac Telephone Company v. U.S.*, 42 F.3d at 188. As noted previously, the FCC now shares this view, as well. *See* p.3, *supra*. Given this broad administrative consensus, Congress would be hard pressed to defend the "reasonableness" of its judgment, even if that were the relevant constitutional standard.

no effort whatever to develop facts indicating that cross-subsidization or sabotage was a highly likely (as opposed to a possible) consequence of permitting local telephone companies to speak freely and, since the government has made absolutely no effort to explore methods of preventing the feared evils without resorting to censorship, the speech ban cannot satisfy any level of First Amendment scrutiny. *Turner Broadcasting System, Inc. v. FCC*, 114 S.Ct. 2445; *Sable Broadcasting Communications v. FCC*, 492 U.S 115 (1991).

The only standard of review capable of upholding §533(b) would be a return to the discredited "bad tendency" test last applied in *Gitlow v. New York*, 268 U.S. 652 (1925). Stripped of its rhetoric, the United States argues that permitting local telephone companies to speak over local telephone lines would have a "bad tendency" to encourage cross-subsidization or sabotage. Not since *Gitlow* has a flat ban on speech been sustained on the basis on such speculative predictive judgments.

Prior to the pathbreaking free speech opinions of Justices Holmes and Brandeis,[20] government was free to censor speech whenever the majority had a "reasonable belief" that speech had a "bad tendency" to lead to undesirable behavior. *E.g.*, *Abrams v. United States*, 250 U.S. 616); *Gitlow v. New York*, 268 U.S. 652. Justices Holmes and Brandeis recognized that the "bad tendency" standard was inadequate. The essence of modern free speech protection is a

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[20] *Schenck v. United States*, 249 U.S. 47 (1919); *Abrams v. United States*, 250 U.S. 616, 627 (1919)(Holmes and Brandeis dissenting); *United States ex rel. Milwaukee Soc. Democrat Publishing Co. v. Burleson*, 255 U.S. 407, 436-38 (1920)(Holmes, J., dissenting); *Gilbert v. Minnesota*, 254 U.S. 325, 337 (1920)(Brandeis, J., dissenting); *Pierce v. United States*, 252 U.S. 239, 272-73 (1920)(Holmes and Brandeis, JJ., dissenting); *Schuyler v. United States*, 251 U.S. 466, 482 (1920)(Holmes and Brandeis, JJ., dissenting); *Whitney v. California*, 274 U.S. 357, 372-78 (1927)(Brandeis and Holmes, JJ., concurring).

rejection of the bad tendency/reasonable belief test in favor of some form of heightened judicial scrutiny of a censor's claim that speech should be banned because it creates a risk of future harm.

In traditional speech contexts, the bad tendency/rational basis test has been supplanted by the rigorous "clear and present danger" test, requiring an almost certain causal nexus between speech and the harm it is alleged to cause. *Brandenburg v. Ohio*, 395 U.S. 444 (1969). In commercial speech contexts, the heightened causation standard is reflected by the requirement that a would-be censor demonstrate that censorship is "necessary" to "directly" and "materially" advance the asserted government interest. *Ibanez v. Florida Board of Accountancy*, 512 U.S. __, 114 S.Ct. 2084 (1994); *Edenfield v. Fane*, 507 U.S. __, 113 S.Ct. 1792 (1993); *Central Hudson Gas & Electric Corp. v. Public Svc. Comm'n*, 447 U.S. 557 (1980). In cases involving regulation of a cablecaster's "gatekeeper" powers, the heightened causation standard requires a would-be censor to demonstrate a significant likelihood that its predictive judgments are correct. *Turner Broadcasting System, Inc. v. FCC*, 114 S.Ct. 2445.

Amici believe that the appropriate standard of review in this case -- whatever label is used -- reasonably requires the government to prove that the asserted evils of cross-subsidization and sabotage are almost certain to occur unless the speech is banned. But even if the somewhat less demanding standard applied in *Turner Broadcasting* is utilized, the government's unsubstantiated fears do not come close to demonstrating a clear likelihood that censorship is necessary to avert a serious evil. At most, the government has shown that a temptation to engage in unlawful activities would exist. But if government may prevent speech to avoid temptation, nothing is left of the great Holmes/Brandeis legacy.

D. Where, As Here, The Government Grants A Speaker Monopoly Control Over A Significant Amplifying Technology, Government May -- And Perhaps Must -- Assure Competing Speakers Fair Access To The Amplifying Technology

Modern, vertically integrated speakers perform two discrete tasks. First, they function as traditional speakers, crafting a message to be communicated to an audience. Increasingly, though, they also function as amplifiers, acting as conduits for their own speech, or for the speech of others.

It is, *amici* believe, crucial to distinguish between the speaker and the conduit functions. Efforts to regulate the speaker function directly implicate core First Amendment concerns and must satisfy exacting constitutional scrutiny. *E.g.*, *FCC v. League of Women Voters*, 468 U.S. 364 (1984). Where, however, regulation of the conduit function does not unduly impinge on the speaker function, the regulation may actually advance First Amendment concerns by assuring that diverse voices have access to modern forms of amplification technology.

Where, as in the newspaper context, a speaker's control over amplifying technology is the result of purely private activity, the government's power to regulate the technology in the name of fair access is strictly circumscribed. *Miami Herald Publishing Co. v. Tornillo*, 418 U.S. 241 (1974). Where, as in the cable context, a speaker's gatekeeper control over important amplification technology is, in part, the result of significant government cooperation,[21] narrowly

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[21] Cable systems require substantial cooperation from local governments in order to lay wires under the streets, or to erect and maintain an above-ground wire network.

tailored regulation of the gatekeeper function to assure fair access is permissible. *Turner Broadcasting System, Inc. v. FCC*, 114 S.Ct. 2445. Similarly, in the broadcast context, where control over amplifying technology is the result of a government decision to vest the technology in a finite number of licensees, regulations designed to assure access to the technology by divergent voices have been upheld. *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367 (1969); *CBS, Inc. v. FCC*, 453 U.S. 367; *National Broadcasting Co. v. United States*, 319 U.S. 190. In the context of local telephone companies, where control over the amplification technology is the result of a government awarded monopoly, *amici* believe that regulations needed to assure fair access by divergent voices are not only permissible, they may well be mandated by the First Amendment.

The constitutional problem with §533(b) arises from the fact that it is not targeted at the amplification technology controlled by the local telephone companies but at their ability to function as First Amendment speakers. This statutory scheme, therefore, is very different than *FCC v. National Citizens Comm. for Broadcasting*, 436 U.S. 775 (1978), which upheld a cross-ownership rule that prevented a single speaker from gaining control of two significant forms of amplification technology in the same locality. Section 533(b) completely prevents a local telephone company from using its own property to speak at all in its local community. Under the NCCB cross-ownership rules, a speaker was forced to choose between control of two attractive amplification technologies. Once the choice was made, however, the speaker was free to operate as a vertically integrated speaker without restriction. Under §533(b), on the other hand, a local telephone company is not given a choice of amplifying technology. Section 533(b) flatly bans any effort to use cable or telephone wires to function as a speaker in its local community. Thus, its constitutionality should be

measured by the most stringent First Amendment standards -- a test that the government concedes cannot be met.

Once §533(b) is invalidated, though, the legal landscape is radically altered. At that point, local telephone companies are free to act as vertically integrated speakers, taking advantage of a government awarded monopoly over a significant amplification technology. Under these circumstances, it may well be appropriate to insist that such a government-aided speaker has a constitutional duty to make a significant portion of the amplification technology available to other voices, either by leasing channels, or by providing access to existing channels. *See Turner Broadcasting*, 114 S.Ct. 2445; *cf. Lebron v. National RR Passenger Corp.*, 513 U.S. __, 115 S.Ct. 961 (1995). The precise nature of the First Amendment duty of fair access imposed on a speaker enjoying a government granted monopoly over significant amplification technology, however, need not be resolved in the present case.

CONCLUSION

In considering the role of the First Amendment in an era of rapidly evolving technology, we are not forced to choose between the unpalatable extremes of broad government regulation over speech and virtual immunity from regulation. Instead, by precisely distinguishing between regulation of the speaker and regulation of the conduit, we can enjoy a carefully calibrated system of law that insulates speakers from content control while encouraging a diversity of speakers in the marketplace of ideas.

The judgment of the Fourth Circuit invalidating §533(b) should be affirmed.

Respectfully submitted,

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Nos. 94-1893 and 94-1900

In the Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, ET AL.,
PETITIONERS

v.

THE CHESAPEAKE AND POTOMAC TELEPHONE
COMPANY OF VIRGINIA, ET AL.

NATIONAL CABLE TELEVISION ASSOCIATION, INC.,
PETITIONER

v.

BELL ATLANTIC CORPORATION, ET AL.

ON WRITS OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

SUGGESTION OF MOOTNESS

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In the Supreme Court of the United States

OCTOBER TERM, 1995

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On December 6, 1995, the Court heard oral argument in these cases, presenting a First Amendment challenge to 47 U.S.C. 533(b), which prohibits local exchange carriers (LECs) from operating cable

television systems within their service areas. On February 8, 1996, the President signed into law the Telecommunications Act of 1996, which, among other things, repeals Section 533(b). See Pub. L. No. 104-104, § 302(b) (1996). Section 302(b)(1) specifically states that "[s]ubsection (b) of Section 613 (47 U.S.C. 533(b)) is repealed." The legislation does not contain any specific effective date applicable to that repealing provision, and so it took effect on the date of the President's signature. See *Gozlon-Peretz* v. *United States*, 498 U.S. 395, 404 (1991).

Because the provision under challenge in these cases has been repealed, the cases are now moot. *Burke* v. *Barnes*, 479 U.S. 361, 363-364 (1987); *Hall* v. *Beals*, 396 U.S. 45, 48 (1969). The complaint in these cases requested a declaration that Section 533(b) is unconstitutional and an injunction against its enforcement; the plaintiffs did not request damages or any other relief based on past enforcement of the repealed provision. J.A. 16. Therefore, former Section 533(b) has no further, continuing effect on the parties before the Court.

Under the Communications Act of 1934, as now amended by the Telecommunications Act of 1996, no provision prevents a LEC from establishing a new cable system, in competition with the incumbent cable operator, in its own service area. Section 302(a) of the Telecommunications Act of 1996 does contain some restrictions on acquisition of incumbent cable operators by LECs. Under a new Section 652 of the Communications Act, no LEC or its affiliate may acquire more than a 10% financial interest in any incumbent cable operator offering cable service in its service area; conversely, no cable operator may acquire a similar financial interest in any LEC offering

local telephone service within its franchise area. The new legislation also provides several exceptions to these restrictions on acquisitions, for small cable systems, and for cable systems operating in nonurban areas; in addition, a LEC may acquire a cable system in its service area if (among other things) the cable system is not in the top 25 television markets, the market is served by more than one cable operator, and the subject cable operator is not the one with the most subscribers in the market. The legislation further authorizes the FCC to waive the restriction on acquisitions of incumbent cable operators by LECs under certain circumstances. Those provisions (which, of course, have not yet been considered by any court) are not at issue in the cases presently before the Court, and so they do not prevent the cases from becoming moot as a result of the enactment of the 1996 Telecommunications Act.

Because the provision under challenge has been repealed, these cases are now moot. The proper course is for the Court to vacate the judgment of the court of appeals and to remand the cases, with instructions to dismiss them as moot. *United States* v. *Munsingwear, Inc.*, 340 U.S. 36 (1950); *Preiser* v. *Newkirk*, 422 U.S. 395 (1975); *Burke* v. *Barnes*, 479 U.S. at 365.

For the foregoing reasons, the judgment of the court of appeals should be vacated, and these cases should be remanded with instructions to dismiss them as moot.

Respectfully submitted.

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RESPONSE TO SUGGESTION OF MOOTNESS

The Telecommunications Act of 1996 does not moot this case.[1] Although the Act formally repeals 47 U.S.C. § 533(b), it substitutes new provisions that keep in place, for at least six months, the prohibition on a telephone company's provision of video programming to its local telephone subscribers over an "open video system" (the Act's new name for "video dialtone").

In this lawsuit, respondents have sought to speak over just such an open video system. *See* J.A. 13 (Complaint ¶ 28). As the Solicitor General has acknowledged, respondents' "principal objective" in this litigation was to establish their right "to develop a video dialtone system on their own telephone network for the transmission of their own programming." Govt. Br. 42. Because

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[1] Pursuant to Rule 29.6, respondents incorporate the statement of parent companies and nonwholly owned subsidiaries contained in the Response to the Petitions for Certiorari.

the new Act preserves § 533(b)'s ban on the precise form of video speech at issue in this case, the controversy before this Court remains very much alive. The Court should therefore reject the Solicitor General's suggestion of mootness and deny his request to dismiss this case.

1. Respondents challenged § 533(b) both on its face (J.A. 9-13) and as applied to their provision of video programming over a proposed video dialtone network in Alexandria, Virginia (J.A. 13-14). In the district court, the Government conceded that the facts surrounding the Alexandria video dialtone network "typifie[d]" the application of § 533(b) and that a facial challenge was therefore appropriate. Govt. Summary Judgment Br. 79 (May 22, 1993). The district court agreed and ultimately invalidated that law both on its face and as applied. *See* Pet. App. 108a n.36; *see also* Pet. App. 6a (opinion of the Court of Appeals).

While § 302(b)(1) of the 1996 Act formally repeals 47 U.S.C. § 533(b), § 302(a) of the Act qualifies that repeal by adding new language governing a telephone company's provision of video programming directly to subscribers.[2] First, the Act gives a telephone company limited authority to provide video programming over its own non-common carrier "cable system." *See* 47 U.S.C. § 651(a)(3)(A).[3] Although the facial relief granted below permitted respondents to provide video programming in that manner, the complaint in this lawsuit alleged no plan for doing so. Second, the Act allows a telephone company to provide video programming over an "open video system," but only "[t]o the extent permitted by such regulations as the [FCC] may prescribe

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[2] *See* 47 U.S.C. §§ 651, 652, and 653 (added by the 1996 Act).

[3] The authority may be exercised in most cases only by building a new cable system, not by acquiring or managing an existing one. With several exceptions, the Act forbids a telephone company or its affiliates from acquiring "more than a 10 percent financial interest, or any management interest, in any cable operator providing cable service within the local exchange carrier's telephone service area." 47 U.S.C. § 652(a).

consistent with the public interest, convenience, and necessity." 47 U.S.C. § 653(a)(1).[4]

No such regulations exist today. The 1996 Act directs the FCC to promulgate regulations "[w]ithin 6 months after the date of enactment of the Telecommunications Act of 1996." 47 U.S.C. § 653(b)(1).[5] The absence of regulations in the interim translates into a continuation of the flat prohibition on speech: A telephone company is absolutely barred from providing video programming over an "open video system." Until the FCC adopts new rules to govern speech over such systems, and until those rules actually take effect, respondents may not provide their own programming over their own common carrier network directly to their telephone subscribers.[6]

The Act does allow telephone companies to provide video programming over a cable system — and to that extent may offer

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[4] Although "open video system" is not defined, the term is meant to include at least the "video dialtone systems" for which the FCC previously proposed to grant waivers of § 533(b). *See* 47 U.S.C. § 653(a)(1) (added by the 1996 Act) (describing the nature of an "open video system"); *compare* Third Report and Order, *Telephone Company-Cable Television Cross-Ownership Rule, Sections 63.54-63.58*, 10 FCC Rcd 7887 (1995).

[5] Congress terminated the effectiveness of the FCC's video dialtone rules (§ 302(b)(3) of the 1996 Act) because they had "created substantial obstacles to the actual operation of open video systems" (S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 179 (1996)), and had "served as an obstacle to competitive entry" by telephone companies. *Id.* at 57. Congress left unaffected, pending the FCC's promulgation of new rules, the provision of programming over any video dialtone system previously approved by the FCC. § 302(b)(3) of the 1996 Act; *see* S. Conf. Rep. No. 230, at 179.

[6] Given the long history of regulatory delay in this area since 1987, *see* Resp. Br. 37-38, the ban on speech may well be retained for substantially longer even than the six months specified in the statute. The deadline is not self-enforcing: nothing in the statute authorizes telephone companies to provide video programming over open video systems if the FCC simply fails to adopt regulations within the six-month period. Nor can the deadline be enforced by mandamus, because under a statutory delegation like this one, a court "cannot order the promulgation of any particular regulation or set of regulations." *Plan for Arcadia, Inc. v. Anita Assocs.*, 501 F.2d 390, 392 (9th Cir. 1974), *cert. denied*, 419 U.S. 1034 (1975).

respondents an "alternative channel of communication."[7] But a limited opportunity to speak over a cable system does not moot a controversy concerning the continuing ban on speech over an open video system. A ban on the provision of video programming to subscribers, whatever its scope or duration, cannot survive even intermediate scrutiny (let alone strict scrutiny), because its focus on the editorial function as such assures that it cannot meet the requirement that it be narrowly tailored to an important governmental interest. *See* Resp. Br. 12-34.

Far from mooting the controversy, therefore, the 1996 Act *perpetuates* the controversy. It does no more than require the FCC, at some point in the future, to take regulatory action that might *then* moot this case. Until some such action is taken, however, this Court retains — and should exercise — its power to adjudicate the case on its merits.

2. This Court's precedents do not support the Solicitor General's suggestion of mootness. On the contrary, the Court has made clear that a case does not become moot when, as here, a challenged law is repealed after grant of certiorari and replaced with a different statute that disadvantages the plaintiffs "in the same fundamental way." *Northeastern Florida Chapter of Associated General Contractors v. City of Jacksonville*, 113 S. Ct. 2297, 2301 (1993).

Repeal of a challenged statute can moot a case, of course, if it brings the controversy truly to an end. Had Congress eliminated § 533(b) without retaining a ban on precisely the video speech described in the complaint — had it thereby left respondents free to do *now* exactly what they claimed in this action a First Amendment right to do — this case would be over. For example,

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[7] Even the scope of this avenue is subject to doubt. The 1996 Act contains no language defining "open video systems." Such a definition would be necessary for a telephone company to know with certainty where not-yet-permitted "open video systems" end and now-theoretically-permitted cable systems begin. In the absence of such a definition, a telephone company must guess when and how, if at all, it might be allowed to use its own telephone network to provide video programming without complying with the FCC's yet-to-be-promulgated "open video system" regulations.

in *United States Dep't of Justice v. Provenzano*, 469 U.S. 14 (1984) (*per curiam*), where the Government as petitioner claimed that a Privacy Act exemption allowed it to withhold information sought under the Freedom of Information Act, the case was mooted by an amendment to the Privacy Act that resolved the issue squarely in respondents' favor.[8]

The 1996 Act has no such effect. By preserving for at least six months (and perhaps much longer) a ban on precisely the form of video programming that respondents seek to provide, the new statute prolongs, rather than terminates, the controversy.

This case is thus controlled by *Associated General Contractors*. Shortly after this Court granted certiorari in that case, the respondent City of Jacksonville repealed its challenged Minority Business Enterprise ordinance and replaced it with a new ordinance that "differ[ed] from the repealed ordinance" in several key respects. 113 S. Ct. at 2300. The Court nonetheless rejected the City's claim that the repeal rendered the case moot. Applying "the 'well settled' rule that 'a defendant's voluntary cessation of a challenged practice does not deprive a federal court of its power to determine the legality of the practice,'" the Court stated that "[t]here is no mere risk that Jacksonville will repeat its allegedly wrongful conduct; it has already done so." *Id.* at 2301 (quoting *Mesquite v. Aladdin's Castle, Inc.*, 455 U.S. 283 (1982)). Focusing on the "gravamen of petitioner's complaint" — namely, "that its members are disadvantaged in their efforts to obtain city contracts" — the Court reasoned that, while "the new ordinance may disadvantage [petitioner's members] to a lesser degree than the old one, . . . it disadvantages them in the same fundamental way." *Id.*

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[8] *See also, e.g., Hall v. Beals*, 396 U.S. 45, 48 (1969) (*per curiam*) (case mooted by statutory amendment granting appellants the specific voting right they sought to vindicate); *United States v. Alaska S.S. Co.*, 253 U.S. 113, 115 (1920) (case mooted by new statute that achieved "[t]he thing sought to be accomplished by the prosecution of this suit"); *Berry v. Davis*, 242 U.S. 468, 470 (1917) (case mooted by new statute that eliminated "[a]ll possibility or threat" of the conduct sought to be enjoined).

The Court's analysis applies with added force to this case. Whereas the new ordinance in *Associated General Contractors* disadvantaged petitioner to "a lesser degree" than the old one, the new law here restricts to precisely the *same* degree respondents' ability to provide video programming over their own common-carrier networks — it absolutely forecloses them from doing so for at least six months.

This is therefore a live case, not one that depends on an exception to mootness. This is not merely "a case that is '*capable* of repetition, yet evading review.'" *Diffenderfer v. Central Baptist Church*, 404 U.S. 412, 414 (1972) (emphasis added) (quoting *Southern Pacific Terminal Co. v. ICC*, 219 U.S. 498, 515 (1911)). The challenged conduct has *already been* repeated — more accurately, has been continued — in the 1996 Act. And, if the Solicitor General's argument prevails, the issue *will* evade review. Nor is this merely "the kind of case that *may* produce irreparable injury if not decided immediately." *Diffenderfer*, 404 U.S. at 414 (emphasis added). It *will* produce irreparable injury — by depriving respondents and other telephone companies of their First Amendment right to use their property for expressive purposes. *Cf. Elrod v. Burns*, 427 U.S. 347, 373 (1976) ("The loss of First Amendment freedoms, for even minimal periods of time, unquestionably constitutes irreparable injury.").

The cost in terms of wasted judicial effort would also be great, in view of the timing of the supposedly mooting event. The legislation was not enacted until nearly eight months after this Court granted certiorari and two months after the Court heard oral argument. When repeal occurs after a case has been briefed and argued, and when this Court has already deliberated regarding its outcome, there is no question that the case has satisfied the functional elements of Article III — a plaintiff with "an actual injury redressable by the court," who can assure vigorous representation in "a concrete factual context." *Valley Forge Christian College v. Americans United for Separation of Church and State, Inc.*, 454 U.S. 464, 472 (1982) (internal quotation marks omitted). Whether the opinion is handed down before or after a change in statutory law hinges primarily on the speed with

which the opinion is drafted and printed. It would be an odd rule that made this factor the decisive one for purposes of mootness.

In *Honig v. Doe*, 484 U.S. 305 (1988), where the Court rejected a suggestion of mootness, the Chief Justice proposed "an additional exception to our present mootness doctrine for those cases where the events which render the case moot have supervened since our grant of certiorari or noting of probable jurisdiction." *Id.* at 331-32 (Rehnquist, C.J., concurring). In his view, the Court's "unique resources — the time spent preparing to decide the case by reading briefs, hearing oral argument, and conferring — are squandered in every case in which it becomes apparent after the decisional process is underway that we may not reach the question presented." *Id.* at 332.

Since this case is not moot under the Court's "present mootness doctrine," there is no need here to consider adopting this view as a new exception to that doctrine. But the Chief Justice's concerns are greatly magnified in a case like this one, where the allegedly mooting event does not occur until months after oral argument. At a minimum, the Court should dismiss a case for mootness at this stage only where it is clear that nothing at all is left of the controversy. Here, the *very core* of the dispute, as framed at the inception of the case, remains both unchanged and vital.

3. If this Court nevertheless concludes that the appropriate response to the 1996 Act is to dismiss the petitions for certiorari on mootness grounds, it should not vacate the judgment of the Court of Appeals.

In applying the *Munsingwear* doctrine, this Court has indicated that the "pivotal[]" question, *Anderson v. Green*, 115 S. Ct. 1059, 1060 (1995) (*per curiam*), is whether this Court's review is "prevented through happenstance," *United States v. Munsingwear*, 340 U.S. 36, 40 (1950), or instead through the "voluntary action" of one of the litigants. *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 115 S. Ct. 386, 391 (1994). Here, if this Court's review is prevented at all, it is prevented not by "happenstance" but by the voluntary decision of one of the parties — the United States of America — to alter § 533(b) after 16 federal judges had unanimously held it unconstitutional. "[C]hanges of legislative rules often seem to provide special

examples of voluntary discontinuance — public officials have surrendered a challenged position." 13A Charles Alan Wright & Arthur R. Miller, FEDERAL PRACTICE & PROCEDURE § 3533.6, at 334 (2d ed. 1984 and 1995 Supp).

Moreover, vacatur is an "extraordinary remedy" to which a party must demonstrate an "equitable entitlement." *Bonner Mall*, 115 S. Ct. at 392. Any decision regarding vacatur "must also take account of the public interest," for "'[j]udicial precedents are presumptively correct and valuable to the legal community as a whole.'" *Id.* (quoting *Izumi Seimitsu Kogyo Kabushiki Kaisha v. U.S. Phillips Corp.*, 114 S. Ct. 425, 428 (1993) (Stevens, J., dissenting)). Neither the public interest nor the private equities favor vacatur in this case.

If this Court were to dismiss this case but leave the Court of Appeals' judgment unaffected, respondents would at least have the continuing protection of an injunction that, in our view, should extend no less to the new Act than to § 533(b). Respondents would also be free to request an appropriate clarifying order under Rule 60(b) of the Federal Rules of Civil Procedure. If the Solicitor General has his way, however, respondents will be stripped of that protection, and the United States may once again enforce a ban on respondents' provision of video programming to subscribers in their service areas. That result would unjustifiably deprive respondents of their hard-won rights; it also would deprive the public of a presumptively correct Court of Appeals decision whose "persuasive force as precedent . . . may save other judges and litigants time in future cases." *In re Memorial Hospital*, 862 F.2d 1299, 1302 (7th Cir. 1988) (Easterbrook, J.).

CONCLUSION

This Court should reject the suggestion of mootness and should deny the request to dismiss this case. If the Court orders dismissal, it should not vacate the judgment of the Court of Appeals.

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ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

REPLY MEMORANDUM IN SUPPORT OF SUGGESTION OF MOOTNESS

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v.

BELL ATLANTIC CORPORATION, ET AL.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

REPLY MEMORANDUM IN SUPPORT OF SUGGESTION OF MOOTNESS

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1. In Section 302 of the Telecommunications Act of 1996 (1996 Act), Congress (a) *repealed* the prohibition in former 47 U.S.C. 533(b) against cross-ownership of local exchange carriers (LECs) and traditional cable

systems in the same area;[1] (b) *authorized* LECs immediately to offer cable service, even over their own telephone wires in their own service areas;[2] (c) *also authorized* LECs to operate "open video systems" over their telephone wires, subject only to regulations to be issued by the Federal Communications Commission (FCC) within six months, consistent with the "public interest, convenience, and necessity;"[3] and (d) *reduced* regulatory burdens on LEC operation of open video systems by, among other things, exempting such systems from municipal franchising and the leased-access requirement applicable

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[1] Telecommunications Act of 1996, Pub. L. No. 104-104 (1996 Act), § 302(b)(1).

[2] Under new Section 651(a)(3) of the Communications Act, as added by Section 302(a) of the 1996 Act, a LEC may operate a "cable system," *or* it may operate an "open video system." Only open video systems must be operated in accordance with the regulations to be issued by the FCC. Operation of an open video system does carry certain advantages over operation of a cable system, such as freedom from municipal franchising requirements and leased-access requirements applicable to operators of traditional cable systems. See new Section 653(c)(1) (exempting open video systems from Section 612 and part III, which includes Section 621, of the Communications Act, 47 U.S.C. 532, 541). On the other hand, operation of a cable system may carry certain advantages, such as freedom from the requirement that capacity be shared if demand for carriage exceeds available channel capacity. See new Section 653(b)(1)(B). The choice of the governing legal regime, however, is largely up to the LECs' election, and in any event LECs are currently free to offer cable service over their telephone wires, if they comply with the generally applicable provisions of Title VI of the Communications Act, covering all cable operators.

[3] 1996 Act § 302(a) (adding new Section 653(a)(1) to Communications Act).

to cable operators.[4] The congressional policy is therefore no longer to prohibit LECs' provision of video programming in their service areas, but rather broadly to permit it. Only if a LEC elects to offer video programming by means of an open video system rather than a cable system—a matter within its control—must it comply with regulations to be developed by the FCC. That regulatory scheme is required by the statute in order to provide safeguards to prevent LECs from discriminating against unaffiliated programmers carried on open video systems and charging unjust and unreasonable rates for carriage on such systems, and, if demand for carriage exceeds channel capacity, to require LECs to share channel capacity with unaffiliated programmers. See 1996 Act § 302(a) (adding new Section 652(b) of the Communications Act).

Given this sweeping change in federal telecommunications policy, it is manifest that, at a minimum, the legislation has been "sufficiently altered so as to present a substantially different controversy than the one the [lower courts] originally decided." *Northeastern Florida Chapter of Associated General Contractors* v. *City of Jacksonville*, 113 S. Ct. 2297, 2301 n.3 (1993). LECs may now build and operate new cable systems. They may also offer cable service over their telephone wires, subject only to the regulations applicable to all cable operators under Title VI of the Communications Act. No approval by the FCC is necessary for LECs to offer such cable service.

Under the 1996 Act, LECs have the additional option of operating an open video system. If a LEC elects to operate such an open video system, then

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[4] 1996 Act § 302(a) (adding new Section 653(c)).

approval by the FCC is necessary. It is difficult to understand how the availability of this additional option disadvantages them in any fashion. But, even if the new legislation does "burden" LECs operating open video systems to a modest degree, because they will be subject to regulatory safeguards to be developed by the FCC—an approach they have long championed as a more narrowly tailored alternative to the cross-ownership bar—it surely does not burden them "in the same fundamental way" as was the case under the former Section 533(b). *Northeastern Florida Contractors*, 113 S. Ct. at 2301. The prohibition imposed by former Section 533(b) on cross-ownership of telephone companies and cable systems no longer exists; accordingly, respondents' challenge to that Section is moot. See *Kremens* v. *Bartley*, 431 U.S. 119, 126-127 (1977); *Princeton University* v. *Schmid*, 455 U.S. 100, 103 (1982); *United Building & Construction Trades Council* v. *Mayor and Council*, 465 U.S. 208, 213 (1984).

This Court must review the judgment of the court of appeals in light of presently existing federal statutory law, not the law in effect at the time that judgment was entered. *Kremens*, 431 U.S. at 129; *Fusari* v. *Steinberg*, 419 U.S. 379, 387 (1975). It also bears emphasis that this case involves the constitutionality of an Act of Congress; time and again, the Court has admonished that, "[c]onstitutional adjudication being a matter of 'great gravity and delicacy,'" courts should "avoid passing prematurely on constitutional questions." *Kremens*, 431 U.S. at 128 (quoting *Ashwander* v. *TVA*, 297 U.S. 288, 345 (1936) (Brandeis, J., concurring)). Whatever may be the constitutional issues raised by the provisions of the new legislation requiring the FCC to issue regula-

tory safeguards against discriminatory conduct on open video systems, those issues have not yet been addressed by any court. At this point, any disputes over those issues "are so unfocused as to make informed resolution of them almost impossible." *Kremens*, 431 U.S. at 134. All of the constitutional issues raised by the case—including the choice between strict scrutiny and intermediate scrutiny, and the proper application of the requisite level of scrutiny—have been fundamentally altered by the enactment of the new legislation. It would not be appropriate for this Court, having granted review to consider the validity of now-repealed legislation, to review the constitutionality of the new law, which has not been the subject of briefing and argument.[5]

Respondents have invoked authority to the effect that "voluntary cessation" of challenged conduct will not moot a controversy, but the Court has not hesi-

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[5] For example: respondents acknowledge that the new legislation offers them an important "alternative channel of communication" (a traditional cable system), but they assert that, until the FCC issues new regulations, they are subject to a "ban" on operating open video systems. They therefore argue that the new legislation still fails constitutional muster because a ban on the provision of video programming to subscribers, "whatever its scope of duration," must fail intermediate scrutiny. Resp. 3-4. A substantial portion of the briefs was devoted to examining, under intermediate scrutiny, the adequacy of alternative channels of communication available to respondents, at a time when respondents were not permitted to operate traditional cable systems, but when the FCC was already moving to permit them to operate video dialtone systems. The 1996 Act has so greatly expanded the opportunities for speech available to respondents that the briefs submitted in these cases would be inadequate for resolving any issue presented by the new legislation.

tated to find a case moot when a statute under constitutional challenge has been repealed after plenary review has been granted. See *Department of Justice* v. *Galioto*, 477 U.S. 556 (1986); *Kremens*, 431 U.S. at 126-127; *Princeton University* v. *Schmid*, 455 U.S. at 103. Although there may be a limited exception to that rule when it appears likely that "the repeal of the objectionable language would not preclude [the authorities] from reenacting precisely the same provision," *City of Mesquite* v. *Aladdin's Castle, Inc.*, 455 U.S. 283, 289 (1982), such a possibility is obviously remote and highly speculative in this situation. The repeal of Section 533(b) was effected, as part of a fundamental restructuring of the Communications Act, after years of close consideration by Congress, and in light of new technological developments. In these circumstances, for the Court to render a decision based on whether the now-repealed provision was constitutionally valid would be tantamount to the issuance of an advisory opinion.

2. There is also no merit to respondents' suggestion that the Court should dismiss the petitions for a writ of certiorari, rather than vacate the judgment below. *Galioto* and *Kremens* make clear that vacatur has been the Court's consistent practice when the mootness has been caused by the repeal of the challenged legislation after the Court's grant of plenary review. "In such circumstances, 'it is the duty of the appellate court to set aside the decree below[.]'" *Galioto*, 477 U.S. at 560 (citing, *inter alia*, *United States* v. *Munsingwear, Inc.*, 340 U.S. 36, 39-40 (1950)).

For the foregoing reasons, and for the reasons set forth in our suggestion of mootness, the judgment of the court of appeals should be vacated, and these cases should be remanded with instructions to dismiss them as moot.

Respectfully submitted.

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